



The Conference Board

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Economic Times

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Editor's Note

The heavy mathematical content of many economics journals has led many people to say that the profession went to the dogs when the word "political" was removed from its name. By the same token, I've often thought the topics this publication features would make it logical to have named it "Political Economic Times." Certainly the articles in this issue point strongly in that direction, especially Suzanne Garment's fascinating look at the process by which scandals are fabricated in Washington and Charles Murray's intriguing thoughts about the way a caste system may be developing in the United States.

In addition, our colleague, Al Sommers, examines (qualitatively and empirically, as is his wont, but not algebraically) the perplexing behavior of the monetary numbers over the past year, and our Colloquium considers whether the policymakers should add more energy to the business cycle.

Here's wishing everyone a pleasurable holiday season.

Ed Fiedler

Maxim of the Month

Cynic: A blackguard whose faulty vision sees things as they are, not as they ought to be.

Ambrose Bierce

Cynicism is an unpleasant way of saying the truth.

Lillian Hellman

What's the Magic in Markets?

The dramatic transformation from detailed, top-down control of economic activity to free market capitalism that has begun in the U.S.S.R., Eastern Europe and Latin America has been cheered by most economists, myself included. Nevertheless, the often wild claims made by extreme partisans of the market system should not go unchallenged. The market, they would have us believe, brings nothing but fair years—a cornucopia of material blessings without interruption or imperfection. And to make room for this market magic, the government should be limited to little more than the military, the police and the courts.

Now I never one to underestimate the power of a platitude have long advocated a leaner and more efficient government, including pared-down spending, fewer regulations, a scaled-back bureaucracy, reduced subsidies, and a less distorting tax system. Nevertheless, I would **not** want to eliminate such agencies as the FDA, the EPA, the FAA, the antitrust agencies, and a great many state and local units including the public schools and those fighting consumer fraud. Most of these organizations are flawed, some deeply. All could and should be greatly improved. But they all carry out important functions that in my view should not be left to the private sector. (I hope they'll soon start to control telemarketing.) For all its benefits, the market system still leaves a very substantial role for government.

But how much **economic** magic will the market deliver in the form of higher living standards? Quite a lot, if we judge by contrasting the economic performance of East and West Germany, North and South Korea, China and Taiwan. And what is it about free markets that fosters these gains? Many things, but let me men-

tion just two: First, markets provide effective incentives by aligning an individual's remuneration with his or her productivity more directly than a command-and-control system does. Second, the market system more effectively marshals all the knowledge available in the system to maximize customer satisfaction.

We cannot, however, expect the economic gains to be realized instantaneously. The differences mentioned above (East and West Germany, etc.) were four and a half decades in the making. Similarly, the transformation of the U.S.S.R. is going to take decades. That's not magic; magic is done in a flash of blue smoke, not in decades. The economic gains are the result of work and perseverance. And some market-based systems don't achieve gains at all, even over a decade or more. So it's wrong to talk about the **magic** of markets as though it's an instantaneous and automatic outcome.

Furthermore, if we think only in terms of material measures like income and consumption, we are ignoring the most fundamental benefits of the transformation now taking place. The most meaningful blessings are the gains in personal freedom. The availability of choices—to choose for yourself your occupation, to live where you please, to continue your formal education or not, to work for others or for yourself, to spend or to save your discretionary income. These choices, this liberation, this enhanced personal autonomy that gives people all these choices to make for themselves—although it doesn't always come easy, that's what's important here. That's the real magic now taking place around the world, the magic of freedom.



Colloquium: More Stimulus Needed?

Background

Complaints about the economy have again reached epidemic proportions. Many are saying that the recession continues, the economy is dead in the water, the recovery is feeble. Some also call for additional stimulus from the Federal Reserve or fiscal policy — tax cuts and extended unemployment benefits — or both.

Question:

Should policymakers provide further stimulus to the economy at this time? If so, what kind and how much? Or is the economy doing well enough that all the talk about policy action should be written off as partisan politics and media hype unworthy of serious consideration?



Don R. Conlan
Capital Strategy Research

The parallels with 1971 are disturbing. Then, as now, a foreign-policy-oriented, Republican president was preparing to run for a second term. Then, as now, the economy was recovering gradually from a mild recession. Then, as now, demagoguery was rampant. Then, political expediency gave us disastrous wage and price controls. If we need anything now, it's lower long-term interest rates. But they're driven by expectations; thus, reopening Pandora's budget is **worse** than doing nothing.



Stephen H. Axilrod
Nikko Securities International

The slump has lasted too long and, yes, the economy needs further stimulus. Net exports have stalled because of slow growth abroad, which places an even greater premium on domestic policy actions to spur spending at home. Monetary policy should act promptly (if it has not already acted by the time this appears) to lower the Federal funds rate closer to or even below the underlying rate of inflation. Every effort should be made to avoid a fiscal stimulus, since over the long run we have to raise national savings.



Lyle E. Gramley
Mortgage Bankers Association

The economy's improvement since last spring meets the standards for a recovery, but it is a joyless prosperity. Momentum is lacking in all sectors, and now the stimulus from rising inventory investment is ending. Policymakers must act soon to prevent the recovery from faltering. Lower interest rates will work, and are a better alternative than fiscal actions. But I wouldn't mind a revenue-neutral fiscal package with a temporary investment-tax-credit centerpiece to add some juice to the economy.



James Tobin
Yale University

What's Greenspan waiting for? The GNP gap is 5 percent and growing. Inflation is dormant. Cut the Funds rate by a point! One by-product, a lower dollar boosting exports, would be especially welcome. "Credit crunch" is a reason for aggressively easy money, not an excuse for inaction or relaxing bank supervision. Tax proposals the President and Congress are rushing into the vacuum are half-baked. However, extending unemployment benefits, trivial in macroeconomic and budgetary consequences, is simple decency.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojniower, Senior Advisor, First Boston Corporation.

The New Political Avengers

by Suzanne Garment



Political scandal is not a new phenomenon in America. On the contrary, such scandal is one of the most pervasive elements of our history, and it persists because it is utterly irresistible. When there is scandal on the scene, it drives out the human appetite for more mundane sorts of political news.

Still, our time is different from the decades preceding it in that it has been shaped by incessant political scandal. The proliferation of scandal reflects not so much an increase in corruption at the federal level as our growing capacity and taste for political scandal production. The resulting culture of mistrust has made the always difficult job of governing measurably harder. The atmosphere of sensationalism has contributed to public cynicism. Our politics has become obsessed with the exhumation of misdeeds, real and alleged.

Moreover, the habit of making large scandals out of what were once thought of as garden-variety misdeeds has enabled us to avoid looking into the mirror and attending to matters, like the savings and loan problem, that spring less from individual wrongdoing than from a more widespread failure of political will. Other issues that are not scandal fodder, like the persistent problems of this country's underclass, attract little public attention.

Charges of wrongdoing have filled the press, crowding out other sorts of political issues. Scandals have periodi-

cally commandeered the attention of the political community and have literally exhausted the time of the officials immediately involved in them. The imbroglios have left bad reputations and low morale in their wake and more generally undermined the legitimacy of individuals attempting to make national policy and run the government.

*Today's myriad scandals
come from the
ever-growing efficiency
with which our modern
scandal-production
machine operates.*

Are We More Corrupt?

How did this scandal wave come about? According to political reformers—in the press, public interest advocacy groups, Congress, and elsewhere—the answer is corruption. In their view, Watergate revealed an American political life filled with acts that are, or should be, crimes. Since Watergate, this argument has exercised great influence over our public life, and government has enacted many new laws and regulations to deal with the problem of official corruption.

Yet these efforts have had ironic results. Since Watergate, despite the growth in our anticorruption efforts, the number of our political scandals has continued to increase. The post-Watergate scandals did not simply proliferate while corruption was being exposed and then abate as politicians began complying with today's new, more rigorous standards. Instead, the scandals have continued at their high levels for more than 15 years, with the recent savings and loan debacle the biggest of all. In other words, the attack on cor-

ruption seems to have had few of the cleansing effects that such efforts are supposed to bring in their wake.

Some of those who pressed for the ethics reforms of the 1970s explain these perverse consequences by saying that the scandals remain numerous because our political life has grown even more corrupt since then. But this crisis of public corruption almost surely does not exist. There are crooks in the federal government, of course, and we will always need corruption-fighters to ferret them out. Moreover, some kinds of corruption have grown along with the growth of government and the benefits it distributes. Yet on the whole, the federal government in recent years has been at least as clean as in the past and probably a good deal cleaner.

Certainly there is no plausible estimate of any actual rise in federal corruption since Watergate that matches the explosive increase in scandal during the same period. A good deal of our current scandal activity stems from heightened ethical sensitivities and a distaste for what were once accepted practices in American politics. For instance, today's political campaigns may not seem ethically attractive to the modern eye, but fund-raising methods now are far more honest than in the days when cash changed hands under the table and individuals did their buying of congressmen in secret.

There is simply no persuasive evidence that the increasing scandal has taken place because of a corresponding rise in corrupt official behavior. Today's myriad scandals come in much larger part from the increased enthusiasm with which the political system now hunts for evil in politics and the ever-growing efficiency with which our modern scandal-production machine operates.

The Passions of Anticorruption

Today's intense focus on government corruption began with the shock of Watergate, but the political passions that inspired the drive were in full flower years before. The energy of today's anticorruption efforts, in fact, emerged during the early 1960s with opposition to Lyndon Johnson's presidency and America's participation in the Vietnam War. The spirit of that opposition was no mere disagreement over policy or even ideology. Instead it increasingly embodied the conviction that the people governing this country were fundamentally illegitimate in their claims to authority and criminal in their behavior.

Since Kennedy's time, traditional political parties and economic interest groups have declined in power. The press and the courts have, correspondingly, grown in importance. So have new kinds of ideologically based interest groups, along with the political professionals who run them. Compromise and private agreement have declined as political strategies, while the use of publicity, litigation, and appeals to moral principle have risen. These changes have produced a new type of politician, more dependent on the media and less inclined to follow party or legislative leadership.

In some respects, the corruption-fighters of today, manning news desks, Capitol Hill offices, and investigating and prosecuting organizations, are very different from the antiwar protesters of the late 1960s. But in their self-righteousness and lack of restraint, they recall the excesses of the most dangerous part of the antiwar generation.

Indeed, by now these ethics-enforcers have become part of a self-reinforcing scandal machine. Prosecutors use journalists to publicize criminal cases, while journalists, through their news stories, put pressure on prosecutors for still more action. Investigators inside government agencies know how to advance their projects by collaborating with congressional committees, while committee staffers use the investigators to bypass agency heads

and gather the material for splashy public hearings. All these players are aided immeasurably by the growing public focus on the politician as a celebrity, subject to intense, probing attention that a celebrity commonly receives. Along the way, the hunt for bad deeds has become a business like any other, and large numbers of people have developed personal stakes in its continuing.

Correcting Our Course

Thus, our present scandal politics has become not only self-reinforcing but virtually endless in its prospects. It is not a party phenomenon, as growing numbers of legislators from both parties find themselves involved in imbrolios. Modern scandal politics exercises a power over government and the public agenda that is now out of proportion to the benefits it brings us. We can free ourselves of its worst effects only if we determine to keep it under control.

*A prosecutorial class with
no sympathy for human
frailties can be a much
greater danger to
democracy than the simple
peddling of influence.*

Today's scandal practices did not simply spring up in response to public demand, they were elaborately crafted by a political elite. This same elite can correct its course. How can this be done?

- We should concentrate more intelligence and energy on getting and keeping talented people in the government.
- Congressional leaders should take control of Congress's investigative function. In the executive branch, it is time to improve the skills, or prudence, and the professionalism of current investigators.
- The office of the independent counsel has become more trouble, more ex-

pense, and more danger than it is worth. It should be abolished.

- Federal prosecutors should continue to prosecute, but it is time for a strong presumption against further criminalization of politics. We need a demystification of the cult of the prosecutor and more healthy skepticism from journalists and others about the information that prosecutors dispense publicly and privately.
- The press will remain pretty much what it is today. But if more people yell publicly, not just about inaccuracies in the media but about the instances in which personal interests blind journalists to the difference between the pursuit of a story and pursuit of the truth, it may have a cumulative effect on the profession.
- Finally, we need a change in attitude. We must recognize that contempt for ordinary politics is a corruption even more dangerous than stealing money from the public till, and that a prosecutorial class with no sympathy for human frailties can be a much greater danger to a democracy than the simple peddling of influence. Today's steep rise in public alienation is fed by incessant scandal, and our mistrust has created political habits and institutions whose workings are almost sure to produce more scandal and more mistrust. In addition, these scandals make it harder for government to work well. If we judge scandals and ideas about ethics by these tougher and more honest standards, we may be able to bring political scandal back to its perennial, venerated, and distinctly secondary place in American public life.

Excerpted from Suzanne Garment, *Scandal: The Culture of Mistrust in American Politics*, Times Books, a division of Random House, Inc. Copyright © 1991 by Suzanne Garment. Ms. Garment is the DeWitt Wallace Fellow at the American Enterprise Institute.

The Great Monetary Quandary



Albert T. Sommers
Senior Fellow and
Economic Counsellor
The Conference Board

The money stock — what the figures mean, what they portend, what to do about them — has been the great statistical and analytical quandary of this halting recovery. A full panoply of respectable statistics bears on the supply of money in the system, and its apparent growth rate. For the past six months, the growth rate of M2 (the money supply broadly defined) has been virtually without a trend, and the growth rate since the beginning of the year has fallen below the bottom of the target range of the Federal Reserve. Not so for M1 (the narrow version) which consists mainly of currency and checkable deposits at commercial banks; the low and nearly negative growth rate of M2 appears in those of its components other than the components that appear in M1 — mainly, the savings, or non-checkable, deposits of the commercial banking system.

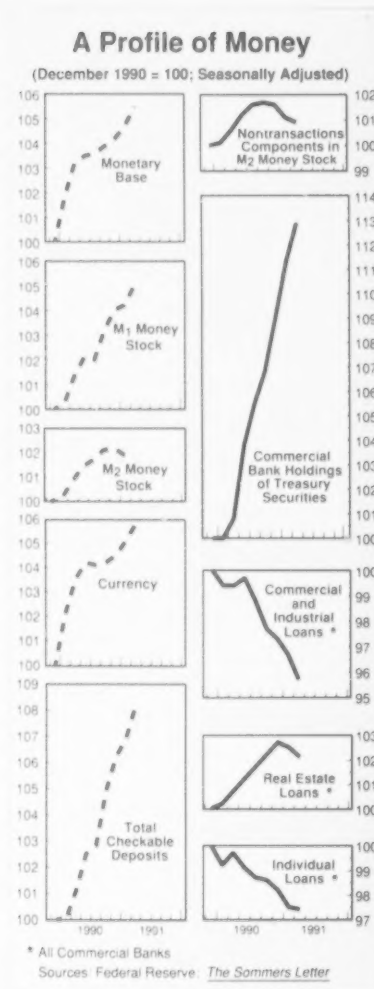
Is this "money scarcity"? A "credit crunch"? Thus far in 1991, the monetary base (currency, plus the reserve positions of commercial banks) has risen at about 9 percent a year, M1 at 7 percent, checkable deposits at 10 percent, currency at 8 percent (see chart) — not much of a crunch. The flabby behavior of M2 has received a lot of attention among analysts, and apparently the Federal Reserve itself; and it has led to pressure on the Federal Reserve to increase bank reserves, and thereby reduce the Federal funds rate, a market used by commercial banks to bolster their reserve positions. A

lower Federal funds rate normally communicates itself to most short-term rates and even to the prime rate itself, since it lowers the cost of money to the banks.

But it is not at all clear that the decline in savings balances at commercial banks represents a true and general decline in the aggregate effective money stock. It has been widely noted that the household sector has been a heavy investor in mutual funds, particularly bond funds, diverting its savings from commercial banks. This is **not** a process in which money is destroyed; instead, it is a transfer of funds from savings accounts to the bond funds, which then invest the proceeds, normally in more bonds. The sellers of the bonds to the mutual funds thus acquire the cash, which they then presumably invest one way or another, perhaps at least initially in checkable deposits that are recorded in M1. This process undoubtedly accounts, in part, for the fact that while the non-M1 components of M2 have been falling, the M1 components have been rising quite satisfactorily — indeed, considerably faster than the rate of inflation.

The fullest and most satisfying explanation of the low rate of growth of M2 is the low rate of growth of lending and borrowing throughout the system, and that appears to be attributable to the reluctance of banks to lend, and the reluctance of borrowers to borrow. Even with 200-point declines in the prime rate and the discount rate, commercial and industrial loans are over 4 percent **below** their level at the end of 1990; individual loans are 3 percent lower.

Where has all the credit gone? Bank holdings of Treasuries are up 13 percent. The same pattern of caution is visible in aggregate debt formation; the growth rate of domestic nonfinancial debt has fallen from 9 percent in 1987, to 6.5 percent in 1990, to 4 percent in 1991. Total nonfederal debt in 1991 has been growing at less than a 3 percent rate. **The great debt cycle of the 1980s is still**



unwinding. That's the real cause of 1991's money puzzle: the money stock figures are the consequences.

The issue confronting the Federal Reserve is whether another reduction of short-term interest rates, which it is perfectly capable of achieving, will stimulate borrowing, even at a time when the banking system as a whole is already very liquid, and investing in Treasury securities at a very high rate (\$58 billion in 1991 thus far). It may be that monetary policy has only moderate leverage on this situation; what's required is the continuing absorption of the excesses of the 1980s. That's going on, but it takes time.

Caste and Conservatism in America

by Charles Murray



There is a dark side looming to the American future, flowing from a prediction that in itself seems innocuous: As national wealth grows in the coming years, so will the proportion of people who are rich. At the end of the Korean War less than one family in a thousand had an income of \$100,000 or more (1988 dollars). By 1988, almost one family in 25 had an income that great, a phenomenally large change.

The numbers of the rich will tend to grow more rapidly in the coming years. Several facts lead to this conclusion, principally the increasing monetary value of complex mental work. This trend has been in evidence for some time. In 1980, for example, a male college graduate made about 30 percent more than a male highschool graduate. By 1988, he made about 60 percent more. And in coming years, the price for first-rate cognitive skills will skyrocket.

The net result is that the rich are going to constitute a major chunk of the population in the relatively near future, and this group will increasingly be the most talented. Why be depressed by this prospect, which in many ways sounds like a good thing? Because I fear its potential for producing something very like a caste society, with the implication of utter social separation that goes with that most un-American of words.

What happens when 10 or 20 percent of the population has enough income to bypass the social institutions it doesn't like in ways that only the top fraction of 1 percent used to be able to do? Robert Reich has called it the "secession of the

successful." The current symbol of this phenomenon is the gated community. But there are many other straws in the wind. A simple example is the way that the fax, modem and Federal Express have already made the U.S. Postal Service nearly irrelevant to the way some segments of American society communicate. A more portentous example is the mass exodus from public schools among urban elites. I sympathize with many of the reasons why people with money take these steps. For almost three decades now, government has failed miserably to perform its basic functions, from preserving order in public spaces to dispensing justice to providing decent education in its schools. But the reasonableness of the motives does not diminish the danger of the potential consequences.

Our increasing national wealth will make it tempting to treat the inner city as an urban analogue of the Indian reservation.

As this American caste system takes shape, American conservatism is going to have to wrestle with its soul. Is conservatism going to follow the Latin American model, where to be conservative means to preserve the mansions on the hills above the slums? Or is it going to remain true to its American heritage, where the thing-to-be-conserved has not been primarily money or privilege but a distinctively American way of self-government and limited government?

All the forces that I can discern will tend to push American conservatism toward the Latin American model. For example, the culture of the urban underclass, increasingly violent and bizarre,



fosters alienation. As each new social experiment fails to diminish the size of the underclass, our increasing national wealth will make it tempting to bypass the problem by treating the inner city as an urban analogue of the Indian reservation.

This temptation will be augmented by the increasing power of people at the upper end of the income scale to use government for their own ends. If the rich constitute 10 to 20 percent of the population, their political power will be so immense as to transform the power equation. The Left has been complaining for years that the rich have too much power. They ain't seen nothing yet.

It will be sadly ironic if the politics of caste are called "conservative," for the greatest bulwarks against the power of privilege are some good old-fashioned American conservative principles. Enforce strict equality of individuals before the law. Prohibit the state from favoring groups, including rich and influential groups. Decentralize government authority to the smallest possible unit. None of these principles is a panacea, for the forces that will tend to produce an American caste system are powerful and complex. But these classic conservative principles are more needed than ever, at a time when the seductions for conservatives to abandon them are increasing.

Excerpted from *National Review*, July 8, 1991. Charles Murray is Bradley Fellow at the American Enterprise Institute.

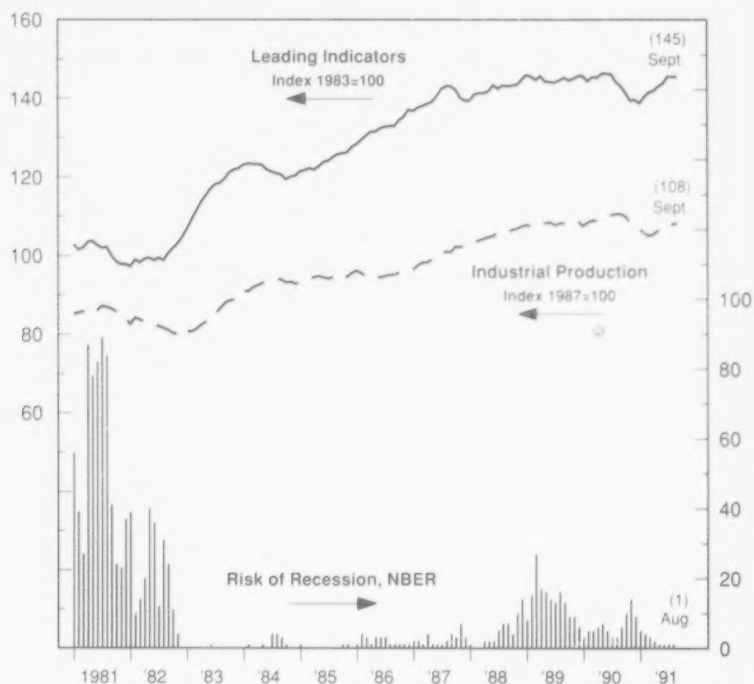
Conference Board Stat File

Sudden Doubt

Quite abruptly, the business cycle outlook has changed, as a variety of key indicators faltered recently. The most disturbing of these was the plunge in consumer expectations (page 10). The net balance of recent portents is summarized nicely by the flattening out of the leading index (this page) in August and September. It's too soon to decide whether or not the cyclical recovery is stalling, but for the first time the data now suggest that possibility. One key indicator that has not stumbled — and usually it is extremely sensitive to any question about the outlook — is stock prices. A likely reason for this, as explained in our Chart of the Month (page 10) courtesy of Shearson Lehman Brothers, is the continuing drop in short-term interest rates.

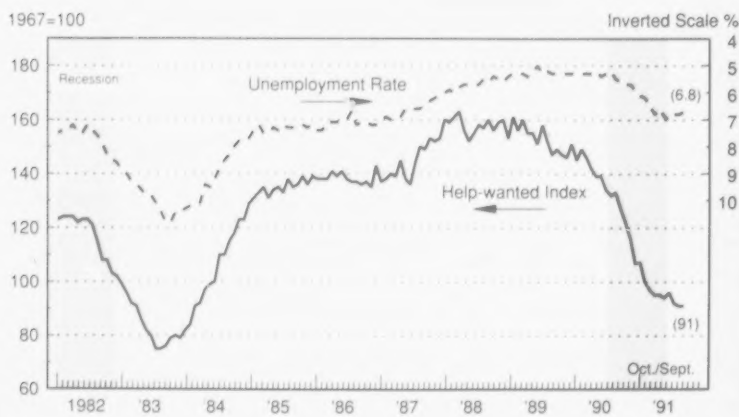
(Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

Early Warning Indicators



Leaders went flat over the summer.

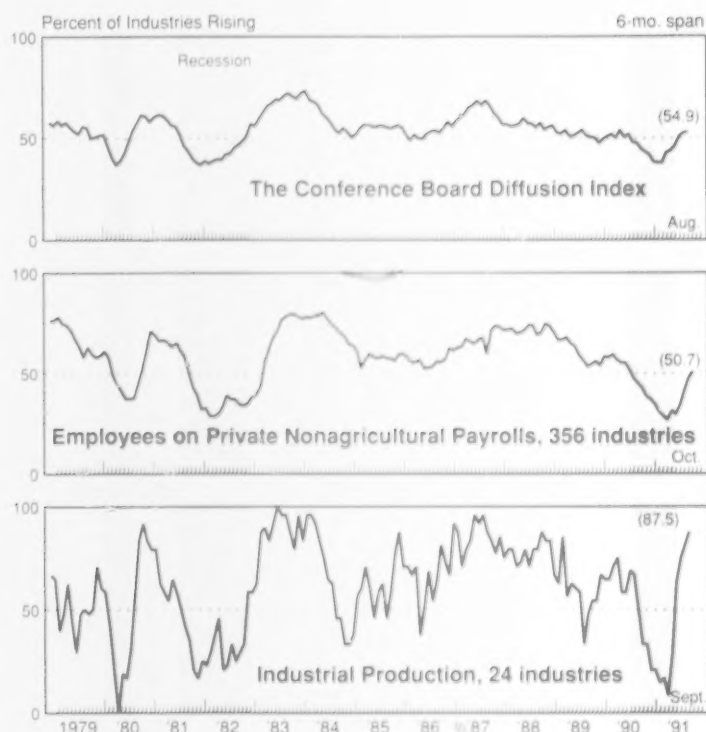
Help-wanted Advertising and Unemployment



Labor market looks soggy.

Conference Board Stat File

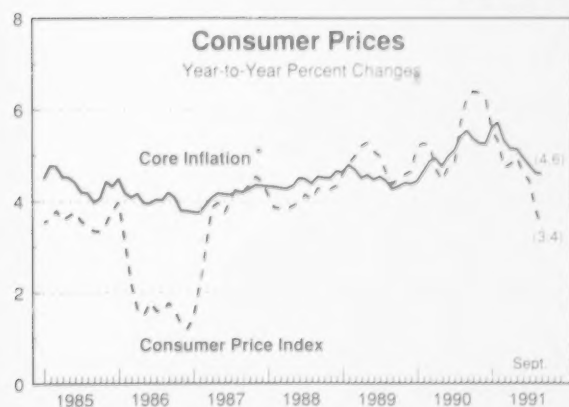
Indexes of Economic Momentum



Momentum continues to be very positive.

Core inflation slowing, but it has not subsided below the average of recent years.

Inflation Fundamentals



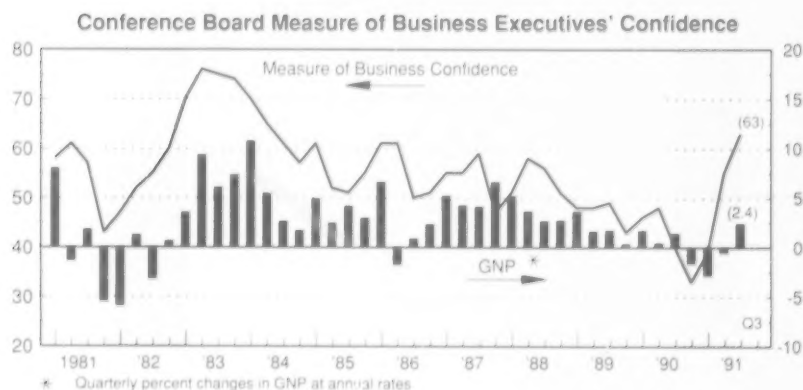
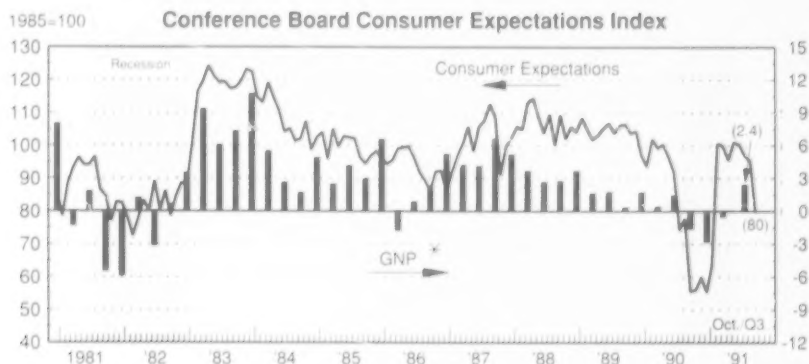
* Core Inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

Confidence



The October plunge in consumer expectations is dramatic

Chart of the Month

Why do stock market analysts watch interest rates so closely? Because for the past 24 years, stock valuations (P-E ratios) have increased when short-term interest rates have fallen, and vice-versa. This inverse relationship between the two has been fairly reliable.

Source: Shearson Lehman Brothers, *Economics*, October 28, 1991, Dr. Robert J. Barbera.



Inside the Crystal Ball

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L.H. MEYER
DRI
WEFA
MICHIGAN - RSQE

Date of Forecast Oct. Oct. Oct. Oct. Oct. Oct. Oct. Oct. Oct. Oct. Oct. Oct.

Gross National Product

(Quarter-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	%		
Actual	1991 1Q	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8	-3.8	1Q 1991	Actual
	2Q	-0.1	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	2Q	
Forecast	3Q	1.9	3.7	2.9	2.3	3.6	2.7	3.7	2.9	2.9	3.0	2.8	3Q	Forecast
	4Q	3.6	3.4	2.8	3.2	3.2	1.4	3.7	1.8	2.4	4.4	2.1	4Q	
	1992 1Q	4.4	2.9	2.8	1.9	3.4	1.3	4.0	2.7	4.2	3.8	3.6	1Q 1992	
	2Q	4.0	2.6	3.0	2.3	3.4	2.0	3.8	3.6	4.1	4.2	3.8	2Q	
	3Q	2.9	2.4	3.4	2.4	3.2	2.7	2.8	3.4	2.9	3.5	3.2	3Q	
	4Q	2.6	2.0	3.4	2.4	3.0	3.5	3.1	3.3	2.4	2.6	2.7	4Q	
1993 1Q	2.6		3.1				2.0	3.2	3.1	3.0	2.3	2.7	1Q 1993	
	2Q	2.8		3.0			1.9	2.3	3.0	3.0	2.6	2.4	2Q	
	3Q	2.9		2.9			2.0	2.0	3.1	2.9	3.0	2.2	3Q	

Inflation (GNP Deflator)

(Percent change from same quarter one year earlier)

Actual	1990 4Q	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	1990 4Q	Actual
Forecast	1991 4Q	3.2	4.0	4.1	4.2	4.5	4.0	3.4	4.0	3.5	3.0	3.7	1991 4Q	Forecast
	1992 4Q	3.1	3.9	3.6	3.4	4.0	4.4	2.9	2.7	2.9	3.0	3.1	1992 4Q	

30-Yr Treasury Bond Rate

(Percent per annum, quarterly)

Actual	1991 1Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	1Q 1991	Actual
	2Q	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	2Q	
Forecast	3Q	8.3	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	3Q	Forecast
	4Q	8.3	8.2	7.8	8.0	7.7	7.7	8.0	7.8	7.9	8.1	7.9	4Q	
	1992 1Q	8.3	8.3	7.8	8.1	7.5	7.4	8.2	7.7	7.9	8.2	7.9	1Q 1992	
	2Q	8.4	8.2	7.9	8.3	7.7	7.5	8.2	7.7	8.3	8.3	7.9	2Q	
	3Q	8.6	8.2	8.0	8.3	7.8	7.7	8.1	7.6	8.2	8.3	7.8	3Q	
	4Q	8.7	8.1	8.0	8.4	7.9	8.0	8.1	7.6	8.1	8.4	7.7	4Q	
1993 1Q	8.7		8.0		8.0	8.1	8.1	7.6	8.2	8.5	7.7	1Q 1993		
	2Q	8.6		8.0		8.1	8.2	8.0	7.5	8.1	8.6	7.7	2Q	
	3Q	8.7		8.1		8.2	8.3	7.9	7.4	8.1	8.7	7.7	3Q	

Unemployment Rate

(Percent, quarterly)

Actual	1991 1Q	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	1Q 1991	Actual
Forecast	1991 4Q	6.8	6.9	6.7	7.1	6.7	6.8	6.7	6.9	6.9	6.9	6.7	4Q 1991	Forecast
	1992 4Q	6.4	6.5	6.3	6.7	6.3	6.6	6.1	6.4	6.2	6.5	6.2	4Q 1992	
	1993 2Q	6.3		6.1			6.6	5.7	6.1	6.0	6.3	6.0	2Q 1993	



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Economic Times

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Editor's Note

We open the new year with an unusually interesting assortment of stories, starting with opinions from our Colloquium about the dominant economic policy issue of the day—whether or not fiscal stimulus is appropriate at this juncture. Marvin Zonis then talks about the risks inherent in the disintegration of the U.S.S.R. Next we get an insightful quote about the environment by Alcoa's Paul O'Neill, followed by William Schneider's views about how the suburbs have come to dominate presidential voting in this country. Then from Earl Butz a typical, no-punches-pulled analysis of U.S. farm policy.

In addition, this being the first month of the quarter, we provide (in the shaded center section) our quarterly special feature, the "Industry Outlook Report," a roundup of the prospects for seven important industries.

Best wishes to all for 1992!

Ed Fiedler

Maxim of the Month:

Take the humbug out of this world, and you haven't much left to do business with.

Josh Billings
(pseudonym of Henry Wheeler Shaw,
American humorist, 1818-1885)

Confidence Index? Or Confusion Index?

The dramatic plunge in consumer confidence this fall has raised some interesting questions. One is the oft-heard idea that our economic problems are all the media's fault: We're being "talked into" a recession by the press and TV. Except for their unrelenting negativism and unwarranted pessimistic interpretations, this argument goes, consumers would pursue their customary free-spending ways, businesses would be hiring and investing, and the economy would be strong, not weak.

This idea is implausible on two grounds. First, although we observe a general correlation between the confidence index and the business cycle, this does not mean that swings in sentiment are a major cause of recessions. A drop in consumer confidence is a consequence of recession, but not an important initiating factor, at least not by itself.

Second, consumer attitudes are probably shaped very little by the media, but primarily by personal experience, that is, by seeing the monthly electric bill suddenly go from \$100 to \$125, or by hearing that your brother-in-law was laid off. That's what worries Joe Sixpack enough to alter his normal spending patterns. On the other hand, what Peter Jennings says is mostly entertainment, without much more economic impact than a movie or a play. One exception that comes to mind was Reagan's firing the air controllers; that episode, promulgated mostly by the media, did get people's attention, even those not directly involved.

I am *not* saying the media have no impact on how our society behaves. I am *not* saying their messages are balanced. But neither do I want to ascribe to them enough power to manipulate the econ-

omy. Even with their howls of despair at full decibel, they are not capable of talking us into recession.

The second and more difficult issue is how to explain the recent drop in sentiment. Usually a sharp decline in attitudes can be traced to something fairly specific, like Iraq's invasion of Kuwait, or gasoline prices skyrocketing. Not this time. Long ago, Al Sommers found a fairly close relationship between consumer sentiment and stock prices, the rate of inflation, the factory workweek, and more recently help-wanted advertising. But none of these indicators, individually or collectively, deteriorated sharply this fall when the confidence index collapsed. So the historical pattern seems to have broken down.

One possible explanation is that sentiment improved last spring because of the Gulf War victory, but then collapsed again this fall when we found the recession still with us. This seems plausible at first pass, but it crumbles when you look at the full range of cyclical indicators. The only other series that's turned somewhat sour lately is initial unemployment claims. But if the recession were "double-dipping" now, we ought to have seen meaningful deterioration in many of the following: the stock market (normally the most sensitive cyclical indicator of all), housing starts, new orders for durables, the factory workweek, and vendor performance. These series aren't so favorable that we can ignore the plunge in sentiment, but neither do they point toward recession. It's difficult to know, therefore, how much analytical weight to assign to this serious drop in consumer confidence. Alas, our index of confidence is also a source of confusion.

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Colloquium: How to Energize the Economy

Background:

The sound and fury in the media focus on the underperformance of the economy. The politicians and pundits are nearly unanimous in calling for something—in addition to Federal Reserve action—that would provide geritol for an anemic recovery. The policy advice encompasses everything from middle class tax relief to reinstatement of an investment tax credit to a cut in capital gains tax rates to new IRAs to more federal spending on infrastructure and education.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

Question:

What's your prescription? What, if anything, should the President and Congress do at this stage to energize the economy?

Note: These answers were written just before the Federal Reserve reduced the discount rate to 3 1/2 percent on Friday, December 20, 1991.



John T. Dunlop
Harvard University

Diagnosis: The normal recovery and growth genes of the economy have been structurally damaged by a profligate past—household, corporate and government debt, an impaired financial sector, and belated difficulties of adapting organizations to new markets and technologies. The political tone is destructive with social conflict.

Prescription: Two placebos, a larger shot of monetary juice, and a lot of quiet remedial work on the structural ills. The patient will not be well for some time.



Charles L. Schultze
The Brookings Institution

For the Fed, "Don't just stand there, do something." For the Administration and the Congress, "Don't just do something, stand there." The last thing the American economy of the 1990s needs is an election year bidding war over tax cuts. If by spring the economy remains stalled, then a temporary investment tax credit should be considered.



Robert G. Dederick
The Northern Trust Company

What this country needs is a 3 1/2 percent Fed funds rate—*now*. And, if that doesn't do the trick, something lower. What it does *not* need (but, of course, almost certainly will get) is a bidding war over budgetary ease. Monetary policy has three great virtues: (1) It can be moved toward stimulus *today*. (2) It can be reversed *tomorrow* if conditions change. (3) Its use now would help ward off at least the *worst* fiscal excesses. So, the President and Congress should leave the recovery baby where it belongs—on the Fed's doorstep.



Albert M. Wojnilower
First Boston Asset Management

Nothing will help much until the official capital requirements strangling bank credit are overridden. The Fed must give absolute priority to credit growth. Only in new ventures can joblosers in large corporations and the defense industry salvage their futures. They must be able to borrow despite limited capital. Bolstering lower-income workers, preferably by reducing social security taxes, is the sole potent fiscal medicine. An investment tax credit or small-business capital-gains relief will mean little unless credit eases.

The Danger of Civil War in the Former Soviet Union

by Marvin Zonis



The agreement between the presidents of Russia, Byelorussia, and Ukraine to establish the Confederation of Independent States (CIS) marks the final disintegration of the U.S.S.R. The formation of the Confederation promises greater instability within the rapidly collapsing superpower.

Minsk has been designated the capital of the new Confederation, a city notable primarily for having the best hotel between Warsaw and Moscow. Minsk as the capital insures that the institutions of the Confederation will be trivial. There are few communications links between Minsk and the rest of the Confederation and certainly not enough to exercise extensive power. The center will be weak

and economic collapse now seizing the country. The central government has been covering its budget deficit by printing rubles. In the former U.S.S.R., control of the money supply was determined solely by the speed of the printing press. As a result, the country stands on the brink of hyperinflation. The black market rate for dollars was 40 rubles to the dollar only a few months ago. By mid-November, the rate had hit 100 rubles to the dollar. (The average monthly Moscow factory wage is 300 rubles.)

As the value of the currency collapses, the people flee from the ruble, spending their days trading goods for other goods, anything to avoid taking rubles. (In the land of inflated currency, the dollar and the D-Mark are king, but a pack of Marlboros is a close second.) The new barter economy is just another inefficiency added to an already archaic economy.

The economy remains a command economy. But the collapse of political authority at all levels means that there is insufficient power in the institutions of

his power limited even within Russia. A retired Soviet Air Force general, Dzhokhar Dudayev, called for elections in the Chechen-Ingushetia autonomous region in the Caucasus as a protest of the government's support for the coup. Despite Yeltsin's declaration of the election as illegitimate, Dudayev went ahead and, not surprisingly, was elected president. He duly inaugurated himself and declared his district an independent

The presence of more than 15,000 tactical nuclear weapons raises the staggering spectacle of a nuclear civil war.

country. Yeltsin sent Russian Interior Ministry troops to put down the insurrection. But the Russian Parliament denied his authority and called for negotiations. The troops were withdrawn.

The state, even the Russian state, does not have the power to command. Neither does it have the power to institute the mechanisms that would allow for the functioning of a market economy. For above all, a market economy requires predictability through a legal system that governs economic transactions. But the institution of a legal basis of a market economy requires both orderly legislative procedures and mechanisms to enforce the newly adopted laws. Both are absent in the former Soviet Union.

In the absence of command and in the absence of the mechanisms for a market economy, the economies of the emerging republics that will replace the U.S.S.R. have fallen prey to corruption, banditry, and self-serving greed. As a result of these factors, the overall output



The ruble: 40 to the dollar on the Moscow black market a few months ago, it now takes 100 of these to buy a dollar. Russia is on the brink of hyperinflation.

and control over the nuclear weapons of the U.S.S.R. will remain uncertain.

The new political arrangements do not in the least portend any arrest of the eco-

the state to issue and enforce commands. Even Boris Yeltsin learned that to his humiliation. He was the hero of the thwarted August coup. Yet he found

of the economy continues to fall at the rate of 1 1/2 percent per month.

As the political center and the economy collapse, it appears inevitable that the food distribution system will break down as well and food shortages will seize the country in the coming bitter winter. One result could certainly be mass migration westward into the former satellites but even more likely into the prosperous states of Europe, particularly Germany. The social disruption could be staggering.

Another possibility which must be taken ever more seriously is the possibility of civil war. There are many ways in which such a war might erupt. In Yugoslavia, the federal army, dominated by one republic, attacked the territory and people of another. That might happen in the U.S.S.R. Russia, for example, might use elements of the federal military to at-

tack Kazakhstan to protect the Russian minority in that Muslim republic. There are large numbers of minorities in each of the republics and Russia itself is composed of scores of so-called "autonomous republics" peopled by ethnically and linguistically distinct peoples, such as the Chechen. They could seek their independence, as have the Chechen, or go to war to preserve the unity of their republic as the Georgians fought the Ossetians within Georgia. There is always the possibility that the agents of centralism, particularly within the military, will seek to use force to re-establish the power of the center. Other military units could side with their republics and fighting could break out between units of the armed forces.

Most fearsome, whatever the cause of the fighting, the presence of more than 15,000 tactical nuclear weapons raises

the staggering specter of a nuclear civil war.

Despite the fact that the former U.S.S.R. has not played a major role in the international political economy, then, its fate is of foremost importance. The Group of Seven nations can ill afford to wait for the peoples of the former Soviet Union to settle their own troubled affairs.

Marvin Zonis teaches international political economy at the Graduate School of Business of the University of Chicago, and is the author of the recently published *Majestic Failure: The Fall of the Shah*.

Quotable Quote

Paul O'Neill on Industrial Development and the Environment



The experience of the past three hundred years demonstrates clearly that we can simultaneously achieve a significantly higher world living standard and a sustainable environmental relationship. Those with a more gloomy view make the mistake of believing that economic growth of the undeveloped and underdeveloped world must go through the same stages as have the developed countries, creating in their wake the same environmental trauma but on a wider scale. Recent economic developments provide strong evidence to the contrary. For example, the new entrants into the world automotive market did not succeed by creating products that were produced in the U.S. or Western Europe in the 1920s. They succeeded by going beyond the established standards of value at the time they entered the market. In a negative way the East German Trabant [automobile] makes the point that outdated and environmentally offensive products can persist in closed economies when they could not in open economies.

As the world has become more open to trade, world standards of value to the customer have replaced national standards. And world standards are being set by those with leading-edge technologies and organizational practices, not by those who are exploiting the environment and the people. In this there is a key message for structural change: The world and its people can benefit greatly, both economically and environmentally, by free and open trade.

In this same vein of thought, it seems to me there is a potential change in practice that could be taken almost immediately and on a voluntary basis that would be quite helpful to insure, in fact, that the undeveloped and underdeveloped economies do not follow the same track of environmental experience as the developed world. Namely, a voluntary agreement on the part of companies in the developed world to scrap rather than sell equipment and systems that are shut down in the developed world because of their unacceptable environmental performance. The lost secondary market value could be appreciable but I believe, with the heightened awareness of the worldwideness of our environmental predicament, many companies would subscribe to such an idea.

Paul O'Neill is Chairman and Chief Executive Officer of Aluminum Corporation of America. This statement is adapted from his speech to the World Industrial Conference on Environmental Management, April 10, 1991.

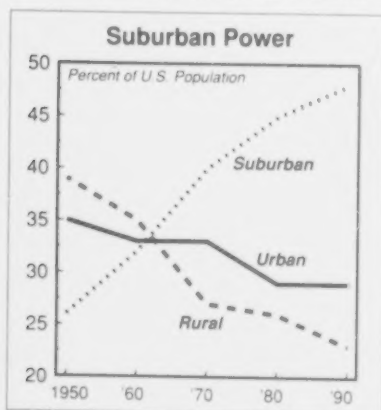
Presidential Voting: The Suburbs Rule

by William Schneider



The suburbs are the new power base in American politics. That's the message of the 1990 census. With 48 percent of the population now living in suburbs, it is almost certain that 1992 will be the first presidential election in which suburban voters will cast a majority of the votes. That's good news for Republicans. The suburbs are the key to that party's lock on the presidency.

In 1960, the nation was roughly a third urban, a third suburban, and a third rural. By 1990 (see chart) the suburban third had grown to almost half. The urban population slipped to under 30 percent. And the rural areas dropped to less than fourth. America is now a suburban nation, with urban and rural fringes.



The suburbs rule. But how do they rule? Presidential politics these days is a race between Democratic cities and Republican suburbs to see who can produce bigger margins. The suburbs are winning.

Since 1960, the urban vote has become smaller but more one-sidedly Democratic. So the Democrats' lead coming out of the cities was about the same in 1988 as it had been in 1960. The rural vote became smaller and more Republican. So the Republican lead coming out of the countryside also stayed about the same.

But the suburban vote grew larger and more Republican. In 1960, when the suburbs cast a third of the national vote, they generated a 3-percentage-point lead for the GOP. In 1988, the suburbs were almost half the vote, and they gave Republicans an 8-point lead, enough to overcome the Democrats' 7-point lead in the cities (see second chart).

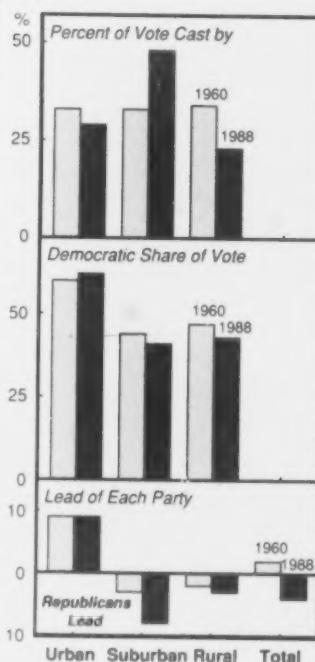
What is happening is that the suburbs are growing larger faster than the cities are becoming more Democratic. That's tipping the balance to the GOP, not just nationally, but in a number of key states.

Take Illinois. In 1960, Chicago cast 35 percent of the Illinois presidential vote. With a little help from the Daley machine, the city voted 63 percent Democratic. In 1988, Chicago's vote was down to 23 percent of the state total. But with no apparent help from the Daley machine, the city voted 69 percent Democratic.

At the same time, the "collar county" suburbs around Chicago became slightly more Republican from 60 percent in 1960 to 62 percent in 1988. The number of people voting in those suburbs grew enormously, however, from 26 percent of the Illinois vote in 1960 (much smaller than Chicago's) to 38 percent in 1988 (much larger than Chicago's).

In 1960, the Democrats came out of Chicago with a 456,000 vote lead. The Republicans came out of the suburbs with a 254,000-vote lead. Illinois went Democratic.

Urban, Suburban and Rural Voting Patterns, 1960 & 1988



In 1988, the Democrats came out of a smaller but more Democratic Chicago with a 420,000-vote lead. The Chicago vote was canceled out by a Republican lead of 423,000 votes in the burgeoning suburbs. Illinois went Republican.

A similar story can be told for Michigan-Detroit, Ohio-Cleveland, Georgia-Atlanta, Louisiana-New Orleans, and other areas. In other words, Republicans can afford to ignore the cities. But the Democrats, like many urban residents, have to worry about becoming trapped in them.

Excerpted with permission from *National Journal*, September 28, 1991. William Schneider is resident fellow at the American Enterprise Institute.

Industry Outlook Report

Overview: An O.K. Outlook



Edgar R. Fiedler
The Conference
Board

Moderate optimism for 1992 is the dominant theme of the industry specialists gathered for this Report. The single notable exception is the small-business sector, where executives report that the economy is in the doldrums nationwide, and their optimism is waning.

In the other six industries, the mood is at least cautiously upbeat. Thanks to lower mortgage rates and the accumulation of some pent-up demand, housing

starts are seen as climbing nearly 20 percent. In the metals and minerals sector, although prices are likely to drift near present levels, global demand is expected to grow modestly.

Marginal retailers and distributors will continue under pressure, but for the apparel industry as a whole 1992 sales growth should outpace inflation slightly and profits should rise more than the 10-15 percent anticipated for the entire economy. Although competition is intense in packaged foods, profits are expected to continue to grow in the 11-12 percent range. Some heavily indebted companies will take advantage of present lower interest rates by restructuring their balance sheets, thereby reducing interest expense.

In health care, the major policy issues of rising costs and limited access remain far from resolution, and the industry continues to grow at a much faster pace than the economy. Finally, the most optimistic

report is for freight transportation, where revenues are expected to increase by a multiple of general economic growth. Productivity advances are being made through improved equipment utilization, advanced technology, reduced train crews, and strategic alliances among the different modes of transportation. Here, too, competition is severe and price increases will remain modest.

The moderately optimistic character of these industry projections stands in sharp contrast to the undiluted melancholy about the economy seen daily in the newspapers and on television, where the implicit expectation is renewed recession. In this respect, our specialists view their industries in much the same way that most forecasters are looking at the economy. Prospects are neither very good nor very bad, but the outlook is OK in that it's reasonable to expect a little expansion in activity in 1992.

Housing: Poised For Expansion, If



David F. Seiders
National Association
of Home Builders

Housing starts fell to about 1 million units in 1991, the lowest level since World War II. The multifamily sector was depressed all year, and the single family market posted only a modest recovery from a cyclical trough hit in January when the Persian Gulf war erupted.

Foundations for a stronger single family housing recovery were built during 1991. A sizable amount of pent-up demand assembled in the wings following several years of below-trend home sales. Furthermore, housing affordability improved during the year as mortgage interest rates fell to their lowest level in 15

years and home prices receded in the weakest regions of the country. On the supply side of the single family market, unsold inventories of new homes dwindled to the lowest level since the 1982 recession, paving the way for an upswing in production.

Market fundamentals in the multifamily sector, on the other hand, were still quite weak as 1991 ended. Apartment vacancies remained high and provisions of the Tax Reform Act of 1986 continued to weigh heavily on investment incentives for rental housing. The condominium market also remained depressed, particularly in the Northeast region where heavy production of earlier years overhung the market.

Thus, 1992 begins with the single family housing market poised for expansion and the multifamily market facing a healing process that has not yet been completed. Further monetary easing by the Federal Reserve should help strengthen home sales and single family starts, despite very low levels of consumer sentiment at the start of the year. The

multifamily market should stage a weak recovery by the second half as the overall economy improves and household formations pick up. Total housing starts should rise by nearly 20 percent in 1992, paced by an upswing in single family starts to about 1 million units. This outcome is contingent on relaxation of a "credit crunch" that severely constrained the flow of housing production credit during 1990 and 1991.



Apparel: Flexibility the Watchword



Jay J. Meltzer
Goldman Sachs

In the prosperous 1980s, so-called, the U.S. apparel industry was buffeted by mini-recessions in mid-1984-1985, late 1987-1988, and late 1989-1990. By early 1991, when many industries first acknowledged an economic downturn, excesses already had been wrung out of the fiber, fabric, and apparel system. Production was curtailed, prices stabilized, import growth flat-

tened, and inventories reduced, often to unsustainably low levels. Part of the gradual improvement in apparel orders in 1991 to date reflected inventory replenishment, a partial return of private label importers to domestic sources (stimulated by state-of-the-art quick response programs), and higher exports. Encouragingly, consumer demand for moderately priced, basic goods also inched ahead in recent months. Thus, apparel seems to be in the forefront of economic recovery.

These trends should continue in 1992, but probably won't be enough to stimulate further significant growth for the industry. Rather, overcapacity and fierce competition should continue to bring pressure on marginal retailers and distributors. Outperformance should stem from creation and implementation of niche strategies, well-conceived programs, attractively valued products, increased pro-

ductivity, and faster responses to consumer needs. National brands should accelerate their market penetration. Manufacturers' outlet stores should become an even more meaningful channel of distribution.

Flexibility will be the watchword of the 1990s, but size and ability to service dominant retailers also will be rewarded. Therefore, acquisitions, mergers, and consolidations, designed to enhance apparel companies' worldwide sourcing and marketing positions, should continue.

Overall, the apparel industry's sales growth in 1992 should outpace inflation slightly, while profit progress should exceed our expectation of a 10-15 percent rebound for the economy. We look for the large, well-run public apparel companies to do even better than the industry average.

Small Business: Stuck In The Mud



William C. Dunkelberg, National Federation of Independent Business

The economy is in the doldrums, the nation's smaller companies are telling us. The small business optimism index (chart) slipped again in November, with 9 of the 10 components losing ground. A 3-point gain in capital spending plans was the only exception, but too much unused capacity exists to justify broad gains in capital formation. Most of the other components look bleak, especially retail sales, employment, and earnings, where survey reports of improvement in mid-91 have subsequently been reversed.

Two sources of encouragement are inventories and inflation. Despite the sales

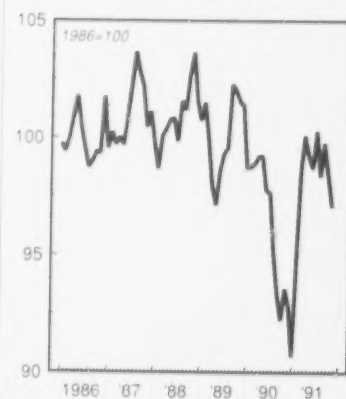
declines reported in recent months, relative satisfaction with current inventories remains good. On the price front, the data are more dramatic: October was the first time in the history of the survey (initiated in 1973) that more firms cut selling prices than raised them. This is good news for inflation and ultimately for bond prices and interest rates.

October was the first time in the history of the survey that more firms cut selling prices than raised them.

Asked to identify their most important problem, these executives again put taxes (24 percent) at the top of the list, as they have for years. Weak demand was next (19 percent); a rising trend marks this as a growing problem. Then came regulation (16 percent). The "also rans" included labor costs (5), labor quality (5), credit crunch (5) and inflation (4). It's customers and profits that are in short supply, not (as Wall Street analysts so often contend) credit.

For the economy as a whole, although the odds of another recession seem relatively low, neither is there any substantial expansion in the offing. Everything is still better than last fall, but most indicators in the small business survey have recently reverted to a downward slope. In the year ahead, the economy may do well to maintain the 2-percent annual growth pace of the past half year, which is too slow to prevent unemployment and excess capacity from creeping higher.

Small Business Optimism



Health Care: Status Quo Untenable



Samuel A. Mitchell
Federation of American Health Systems

The long heralded national debate on the nation's health care system may finally begin in 1992. There is universal consensus that the status quo is untenable; health costs (12.3 percent of GNP in 1990) are absorbing ever increasing shares of corporate, government, and consumer budgets. For a growing proportion of politically sophisticated middle class voters, health insurance is becoming unaffordable and even unavailable.

There is no consensus on what should be done. There are two basic alternatives: government expenditure controls and "managed competition." Government controls save money in the short run, but

would subject 12 percent of GNP to political and bureaucratic control and would not save money long run because politicians are unable to say no to the American public whose thirst for top-of-the-line care on demand would not be abated by rate controls.

Managed competition involves increasing consumer cost consciousness by reducing the tax subsidy for employer-paid health insurance, and by insurance and health service market reforms to encourage price and quality competition, as well as by making insurance affordable for individuals and small groups. By restructuring incentives, managed competition promotes continuous improvement in patient outcomes and patient satisfaction per dollar spent and creates a consumer-driven health system, but it takes longer to work than expenditure controls.

The choice Americans make between these alternatives will greatly affect who pays how much for health costs, the short term rate of spending, and long term service and product improvements. Landmark legislation choosing one of these alternatives is unlikely in 1992, but there is some chance of enacting small employer insurance market reform. Major structural change is likely before the turn of the decade. Regardless, health expenditures will grow faster than GNP for the foreseeable future and, absent expenditure controls, doctors and hospitals will increasingly be subject to cost and quality competition.

Health Expenditures (Projected)

	1992 \$ billion	average annual growth 1992-1995, %
Personal health care	717	10.1
Hospital care	314	10.7
Physician services	166	10.9
Dental	39	6.8
Drugs, medical non-durables	56	6.8
Vision, medical durables	16	7.5
Nursing home	65	9.7
Home health	9	12.5
Other	52	19.8

Metals And Minerals: Demand Rising, Prices Drifting



Phillip Crowson
The RTZ Corporation

Prices of most metals weakened considerably in 1990-1991. Overall demand, however, held up reasonably well with strong growth in Southeast Asia and parts of Europe offsetting weaknesses in North America and elsewhere. The outlook for 1992 is for demand to increase modestly over 1991's levels, gathering

some momentum towards the end of the year. The main driving force will be the performance of industrial activity.

The fruits of investment in new mine capacity will come through more strongly in 1992-93. The impact on supply has so far been mitigated, in copper by inadequate smelting capacity, and more generally by a variety of disruptions ranging from Acts of God to civil war. Many of the disruptions directly result from the skimping of expenditure on repairs and maintenance, and the neglect of advance mine development during the 1980s recession. Where disruptions have been fewest, prices have fallen most.

The main complicating factor has been the collapse of Soviet and East European economic activity. This has greatly reduced internal demand, and diverted or increased exports of metals and minerals

to the West in a frenzied scramble for hard currency earnings. The effects have been a rapid and unexpected build up in Western inventories and weakened prices for those metals where the Soviet Union's exportable surplus or existing stocks are greatest, such as aluminum, nickel and uranium. In other instances, such as molybdenum and tin, weakened Soviet imports have reduced the calls on Western exporters with similar effects. This Soviet imbalance will persist.

Western producers have generally adjusted their offerings too little and too late so that inventories have built up. The outlook consequently is for metal prices to drift for most of 1992 close to present levels, except where special factors operate.

Freight Transportation: Positive Prospects



Thomas J. O'Bryant
First National Bank
of Chicago

Although real GNP growth for 1992 is expected to be sluggish (2 percent) but gradually improve throughout the year, the outlook for freight transportation is very positive, especially when three important trends are considered. Here's what to expect:

First, tonnage volume and revenues will increase by a multiple of GNP growth due to increased inventory investment moderated by today's just-in-time

inventory management practices, and assuming reasonable price stability. Growth will be fueled by investment in capital equipment, not consumption spending. Freight hauled by private carriage will continue to shift towards common carriage due to cost and service efficiencies, thereby adding to the growth momentum for the freight transportation industry.

Second, significant productivity gains will materialize and costs will be reduced further through strategic alliances among truck, rail, air, and ocean shipping. By reducing transportation costs per mile and improving equipment utilization, the motor carrier industry is improving its productivity. Rail is putting into place new labor agreements that reduce train crews and modify work rules. Air cargo, now a global industry, is using advanced technology and route structure changes to increase worldwide system efficiency. Finally, by shifting the product mix to time-definite services, significant yield

improvements will be achieved by all transportation modes even in a very soft market.

Finally, transportation companies are beginning to manage assets to maximize cash flow and attract needed capital. There is a recognition that transportation must generate a sufficient return on assets to attain capital or disappear, and this philosophy is taking precedent over the market share mentality of the late 1980s. This phenomenon is expected to spread because the shipping community is continuing to concentrate its high value freight among sophisticated providers with exacting quality standards and a commitment to improved overall service levels. As a result, we expect industry consolidation trends to accelerate and modest price increases to occur as discounting pressures moderate, even with continuing overcapacity.

Packaged Foods: Competition And Expansion



John M. McMillin, III
Prudential Securities

Despite a more competitive domestic marketplace, packaged food company profits are expected to continue to grow in the 11 percent to 12 percent range in 1992, owing to expanding international markets and favorable ingredient costs. Lower interest rates should also let some companies reduce interest costs by restructuring debt absorbed in the 1980s.

The U.S. marketplace is more competitive as a result of several cyclical and sec-

ular factors. First, the recession is causing much more value shopping by consumers who formerly traded up. Private label products have staged a rebound in a number of categories, thereby forcing more couponing and other promotional efforts by packaged food manufacturers. Second, the growth of warehouse clubs and other discount retailers have forced traditional supermarkets to be more aggressive buyers, thereby making pricing flexibility more difficult for branded food manufacturers. Third, the severe industry consolidation in the 1980s has left a number of deep-pocketed competitors seeking a greater share of the consumer's stomach at seemingly any cost. Pet food, snack food and frozen food are just three major categories that have been gripped with more severe competition.

Packaged food companies are offsetting the more difficult domestic environment by expanding efforts internationally, including Mexico and Canada, both

of which offer sizable opportunities as free trade accelerates. In Europe, major positions have been built up over the years by such companies as CPC, Heinz, Kellogg, Chiquita and Kraft. These positions are paying off in spades as European unity allows production and distribution efficiencies. In Asia, these companies plus Sara Lee and Borden are expanding product lines in hope of building a global brand comparable to Coca-Cola. Regional tastes make these global or even Pan-European strategies difficult challenges for food manufacturers.

Nutritional products, like cereal and pasta, seem to be best positioned in this increasingly health conscious environment. Taste and convenience still mean a lot, but consumers are demanding more low-fat alternatives and the new labeling regulation in 1993 should only accelerate this trend.

U.S. Farm Policy: Costly, Controversial, Counterproductive

By Earl L. Butz



Agricultural Policy in the United States is a mess. Despite near record levels of Federal payments to farmers, news stories persist of farm failures, and pressures on agribusiness firms. Commodity group is set against commodity group as, for example, grain producers seek higher prices and livestock producers grapple with artificially stimulated feed prices.

Our grain and cotton growers are geared to produce for the export market, but they are tied to governmental price and production programs designed primarily for the domestic market. Their first market, too often, is a government warehouse.

In several states in recent years, farmers got more than half of their net cash farm income in the form of a government check. University extension personnel and professional farm managers counsel farmers on how to maximize their government payments, rather than how to maximize yields or to minimize unit costs.

The political voice of American agriculture is in shambles. It arises as a babble from disparate commodity and special interest groups, seldom coordinated and often at each other's throat. We approach Washington as a bunch of predators, each bent on getting a larger slice of what ultimately will become a smaller pie.

It is instructive to note that only about 40 percent of U.S. farm commodities are under effective price support. Commodities without price supports include cattle,

hogs, poultry, fruits and vegetables and, until recently, soybeans. These commodities, in the main, have been profitable. They don't cost the Treasury large sums of money. Producers are free to expand or contract as they choose. They need not seek "permission" from the county ASCS office to plan the scope of their operation. They have expanded their markets.

The troubled areas are precisely those commodities that have had the largest degree of governmental price intervention, including feed grains, food grains, cotton, peanuts, sugar, and tobacco. These are the commodities that have suffered market loss and have borne oppressive production and marketing controls. It is a basic observation that the more governmental involvement in pricing and marketing, the deeper the economic pit in which the commodity wallows.

What Should We Do? First, don't blandly ignore the agenda being put forward by the ecologists, the safe-food lobby, the organic farmers, the consumer activists and similar super zealots. They have strong public appeal. Some environmental actions, wisely guided, can protect agricultural resources and improve agriculture's eroding image with the non-farm sector.

Second, get the government out of the commodity business. That path leads inevitably to expanded competition from abroad, to loss of foreign markets, to curtailed production at home, to the proliferation of government controls, and to reduced farm income.

We have in America a privately owned and operated food distribution system equaled nowhere else in the world. It has its imperfections, but it still turns in an amazing performance. As a matter of national policy, we should be committed to

the preservation and strengthening of that system.

*Basic observation:
The more government
involvement in pricing and
marketing, the deeper the
economic pit in which the
commodity wallows.*

What we have been doing obviously doesn't work. In the long run, farm income and rural welfare can never be enhanced by restricting production, increasing unit costs, withdrawing from markets, expanding governmental controls. The answer must be found in efficiency, lower unit costs, competitive pricing in export markets, favorable macro-policies in the nonagricultural sectors of government, loan rates at market clearing levels, a safety net under agriculture at a level that quits pretending that a government bin is a market, and a signal to our competition abroad that "the honeymoon is over."

Our farm policies are costly, controversial, and counterproductive. By contrast, although it's no nirvana, there is a discipline in the marketplace that works. Let's give it a try.

Earl L. Butz is Dean Emeritus of Agriculture at Purdue University. During 1971-76, he was U. S. Secretary of Agriculture.

Conference Board Stat File

An Uncertain Trumpet

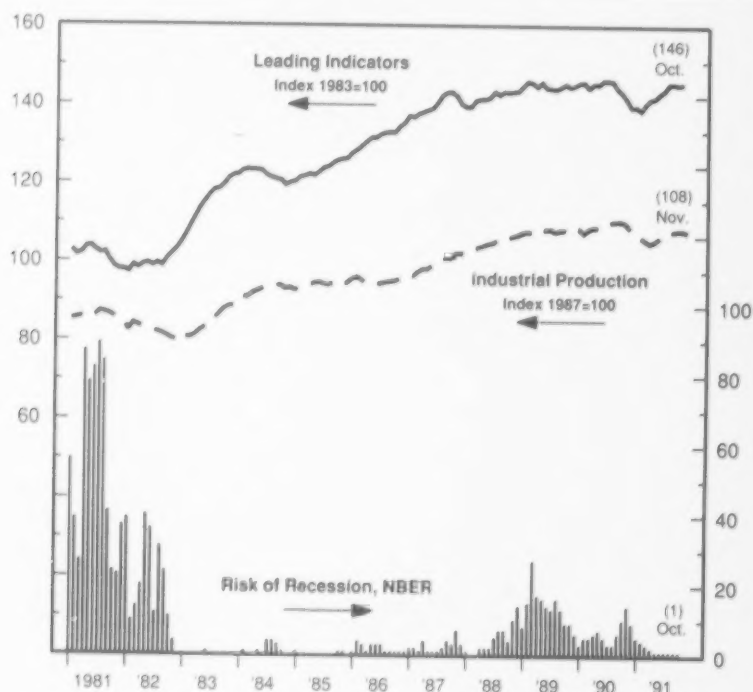
Economists have been talking recovery since spring, but the public disagrees. Mostly this is a difference in definition. To the public, a recession continues until jobs are widely available again. Forecasters, however, focus on direction: When output is falling, that's a recession. Once activity starts to rise again, as it did last May, the recession is over and recovery has begun. So both groups are correct.

Recently, however, the economists are having second thoughts. Since midsummer, what had looked like a brisk recovery has flattened out. In particular, consumer confidence and several labor indicators (pp.8 & 10) are quite negative. Some forecasters are looking for a "double-dip" recession (p.11). But the evidence is mixed, best summarized, perhaps, by the leading index (below), which points sideways, sounding an uncertain trumpet. It supports neither the bulls nor the bears. The guess here is very slow growth but no "double-dip."

(Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

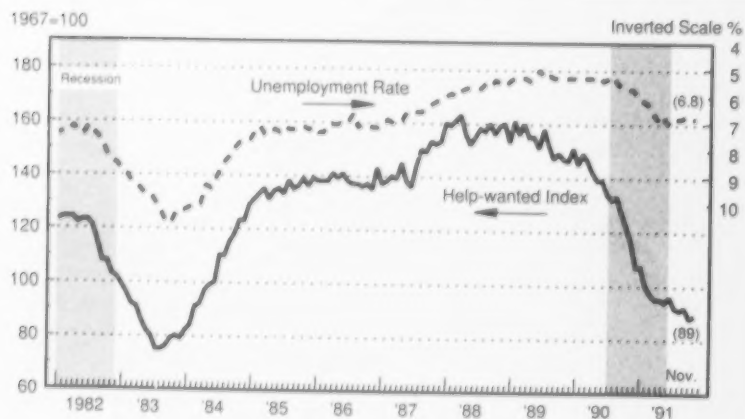
Early Warning Indicators

After brisk early recovery, leading index pointing nowhere.



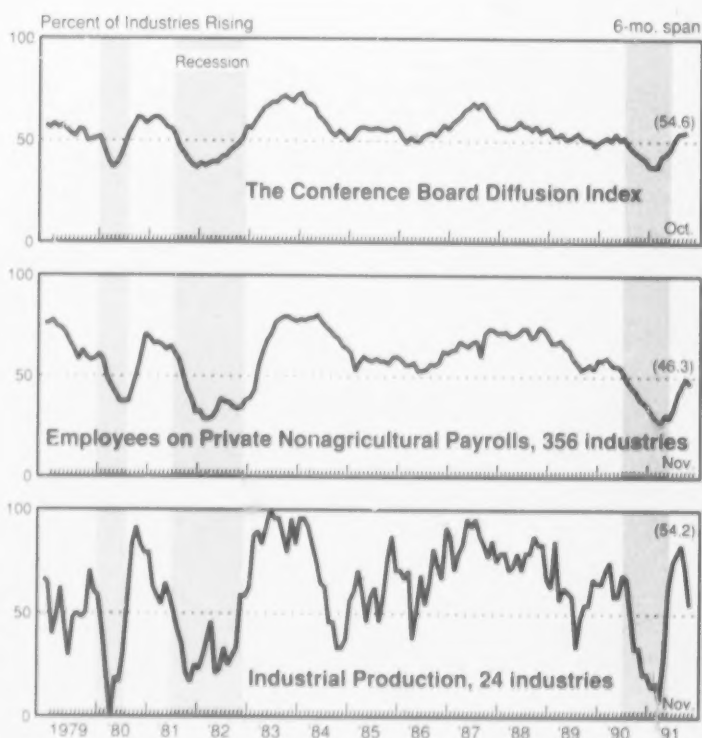
Help-Wanted Advertising and Unemployment

No sign of recovery in the labor market.



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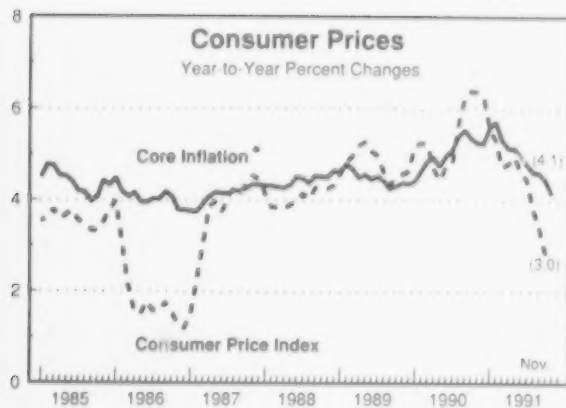
Indexes of Economic Momentum



Momentum still favorable, but less so.

Encouraging slowdown of core inflation.

Inflation Fundamentals



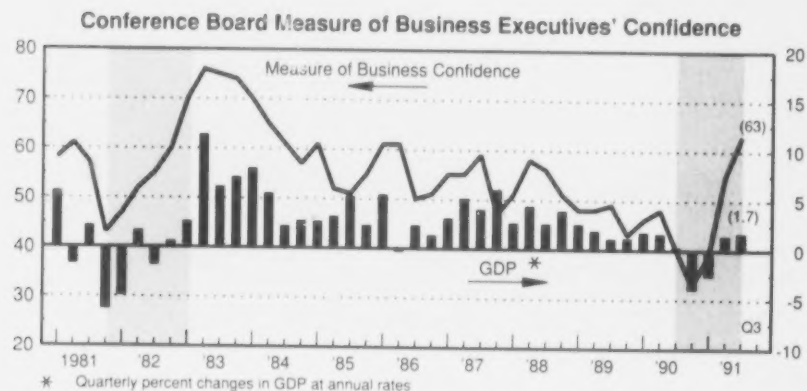
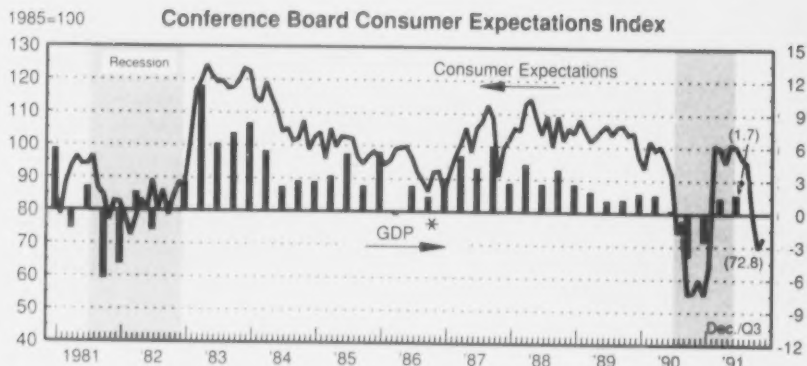
* Core Inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

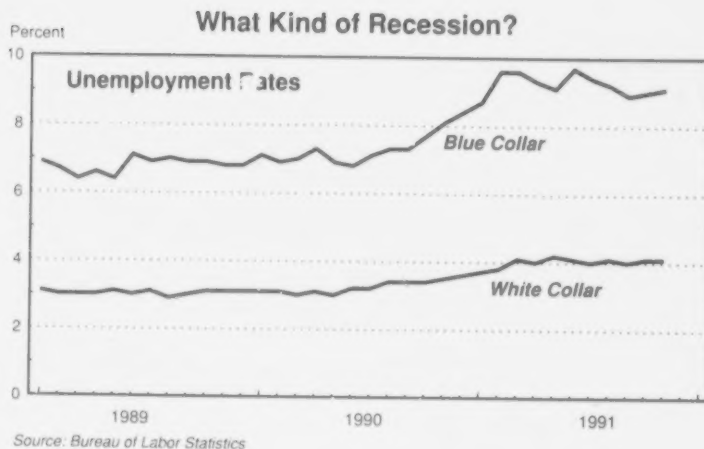
Confidence



Consumer expectations
very depressed.

Chart of the Month

Historically, blue-collar workers have always borne the brunt of recessions. The current business cycle, however, has often been perceived very differently, as one in which accountants, clerks, and managers were the main targets of the layoffs. Indeed, this was often called a white-collar recession. As the chart shows, however, that was a misperception. This recession, like its predecessors, is predominantly blue-collar in its impact.



Inside the Crystal Ball

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Date of Forecast Dec. Dec. Dec. Dec. Dec. Dec. Dec. Dec. Dec. Dec. Nov.

National Economic Output (GDP or GNP)

(Quarter-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	%		
Actual	1991 2Q	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	2Q 1991	Actual
	3Q	2.4	1.7	1.7	1.7	2.8	1.7	1.7	1.7	2.0	2.1	2.4	3Q	
Forecast	4Q	-0.5	-1.0	-0.6	-0.5	1.8	0.3	1.7	0.0	0.6	1.8	0.9	4Q	Forecast
	1992 1Q	-1.0	-1.0	-0.1	0.4	1.8	1.1	2.5	1.1	-0.4	1.0	2.2	1Q 1992	
	2Q	1.4	2.4	3.8	1.1	3.7	1.6	3.9	2.5	2.6	2.8	3.0	2Q	
	3Q	2.9	3.4	4.4	3.2	3.4	2.4	4.0	3.7	4.3	4.0	3.9	3Q	
	4Q	3.3	3.1	4.4	3.2	3.4	3.1	3.8	3.6	4.4	3.9	3.2	4Q	
	1993 1Q	3.4		3.4			2.0	3.9	3.0	4.1	2.5	3.1	1Q 1993	
	2Q	4.1		3.5			2.4	2.7	2.9	3.0	2.5	2.7	2Q	
	3Q	3.3		3.3			1.4	1.9	3.0	2.1	3.1	2.4	3Q	
	4Q	2.6		3.3			1.7	2.8	3.3	1.7	2.5	2.1	4Q	

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Actual	1990 4Q	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	1990 4Q	Actual
Forecast	1991 4Q	3.4	3.4	3.3	3.2	3.6	3.2	2.1	3.4	3.2	3.1	3.4	1991 4Q	Forecast
	1992 4Q	1.8	3.8	3.6	2.8	3.4	3.6	2.9	2.6	3.2	1.8	3.0	1992 4Q	

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual	1991 2Q	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	2Q 1991	Actual
	3Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	3Q	
Forecast	4Q	7.8	7.9	7.8	7.9	7.9	7.8	7.9	7.9	7.9	7.9	7.8	4Q	Forecast
	1992 1Q	7.5	7.7	7.5	7.5	7.6	7.7	8.0	7.5	7.5	7.6	7.7	1Q 1992	
	2Q	7.6	7.8	7.3	7.6	7.5	7.7	8.0	7.6	7.4	7.6	7.6	2Q	
	3Q	7.6	7.9	7.2	7.9	7.6	7.7	8.0	7.6	7.4	7.7	7.6	3Q	
	4Q	7.7	8.0	7.2	7.9	7.7	8.0	7.9	7.7	7.6	7.8	7.5	4Q	
	1993 1Q	7.8		7.2		7.8	8.1	7.9	7.7	7.8	7.9	7.4	1Q 1993	
	2Q	7.8		7.3		7.9	8.2	8.0	7.7	7.9	7.9	7.4	2Q	
	3Q	7.9		7.4		8.0	8.3	8.0	7.6	8.0	8.0	7.3	3Q	
	4Q	8.2		7.5			8.6	8.0	7.5	8.2	8.1	7.2	4Q	

Unemployment Rate

(Percent, quarterly)

Actual	1991 1Q	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	1Q 1991	Actual
Forecast	1991 4Q	7.0	6.8	6.8	6.9	6.8	6.9	6.9	6.9	6.8	7.0	6.9	4Q 1991	Forecast
	1992 4Q	7.5	6.7	6.3	6.9	6.5	6.6	6.6	6.8	6.5	7.1	6.5	4Q 1992	
	1993 4Q	6.8		5.9			6.3	6.1	6.0	6.0	6.7	6.1	4Q 1993	



The Conference Board

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Volume 3, Number 2

February 1992

Economic Times



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(page 10-11)

Editor's Note

This issue provides three innovations, starting with the cover illustration designed to show the liveliness we hope you always find inside. Next, a new feature called "Potpourri," which is a collection of short items we find appealing. Finally, we found so many interesting stories this month we expanded to 16 pages (which in the past we only did for the once-per-quarter "Industry Outlook Report"). We don't expect to put either the Potpourri or the 16-page length in every issue—only when, as this month, our cup runneth over with intriguing material.

We hope you like this month's innovations but, in any event, we're sure you'll like the content. The subject matter of the pieces by Belle Sawhill and Gary Becker are somewhat related. Murray Weidenbaum's piece is more for fun, but includes some thoughtful, serious points as well. And our ever faithful Colloquium panel is as interesting as always.

Ed Fiedler

Maxim of the Month:

Its name is Public Opinion. It is held in reverence. It settles everything. Some think it is the voice of God.

Mark Twain
Europe and Everywhere

Shooting Ourselves in the Foot

The President's trip to Japan intensified economic tensions in both countries. Congressmen tell us the recession is "made in Japan" and threaten to ban all Japanese cars. "Buy American" grabs the headlines. This friction is often referred to as a trade war.

Does this make sense? From an economy-wide point of view, definitely not. When the Japanese sell cars here, they can either spend the proceeds on goods to take back to Japan or (if they don't do that, thus creating a U.S. trade deficit) they invest the money here either buying a U.S. business or stocks and bonds. In both cases (that is, with or without a trade deficit) no money leaves the U.S. economy, and so no lasting harm is done to total economic activity.

Furthermore, all these transactions are consensual. Americans are not being forced to buy Japanese cars. They do so on their own volition, because they'd rather have the Japanese cars than something else. And the Japanese sell the cars here because they want the U.S. goods and companies and securities they buy with the proceeds. Thus both buyers and sellers feel they benefit, and both nations are better off.

This is why the analogy of an international trade war is so badly misplaced. In war, both countries are damaged and one is the loser. In trade, neither economy is damaged. Both Japan and the United States are winners.

Now if trade is all benefits and trade deficits are no problem, what's all the fuss about? Well, thus far I've been arguing strictly from an economy-wide point of view, and the no-harm-done conclusion doesn't hold for individual industries. So the fuss is about jobs and profits

in specific industries, especially autos, which account for the lion's share of the U.S.-Japan trade deficit.

An autoworker or investor has good reason to want to stop Japanese cars from being sold here. But what about the other 98 percent of us? What do we lose if we accept the restrictions the industry wants? We lose the opportunity to buy quality cars at reasonable prices plus the benefits of additional competition and the innovations that come with it. In other words, we lower our standard of living. We shoot ourselves in the foot.

We should remember, furthermore, that competitive displacement is not just an international process, it is universal. In the auto industry, Packard, Studebaker, Nash and many other nameplates were displaced long before foreign cars became an important part of the market. Should the Packard workers and investors have been protected from the Chevs and Fords that put them out of work? More recently, should the big computer makers have been protected against the producers of workstations and personal computers? Should the downtown department stores be protected against the inroads of the Wal-Marts and K-Marts in the suburban shopping malls? How about the thousands of other U.S. companies being outperformed by their competition? Should they be kept in business at the expense of the rest of society? Clearly not. Our standard of living would fall sharply.

Finally, is there any fundamental difference between the domestic examples of competitive displacement mentioned above and the threat the U.S. automobile companies face from Japan? I don't see any.

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Colloquium: How to Energize the Economy

Background:

Most economists are doubtful about the desirability of tax cuts or other fiscal initiatives to boost the economy. But not many politicians, both because of worries about the strength of the economy and because, in a Presidential election year especially, the temptation both to buy votes and to sink still deeper into partisan politics is irresistible. Thus Washington appears to be moving inexorably toward budget changes ostensibly designed to spur the economic recovery.

Question:

If further budget stimulus is inevitable, what should it include? What kind of tax cuts and spending increases should be enacted?



Andrew F. Brimmer
Brimmer & Company

There are no autonomous private sector sources to spur economic expansion. Federal fiscal stimulus is required. It should include two elements: First, a straight 10 percent rebate of 1991 individual income tax liabilities. This would raise 1992 disposable income by \$53 billion—or 13 percent. Most of the gain would be spent, thus boosting aggregate demand. Second, the investment tax credit should be reinstituted at a 10 percent rate and applied to all new investment in equipment.



Charles E. Walker
Charles E. Walker Associates

No spending increases should be adopted (except perhaps for infrastructure). On the tax side, help commercial real estate by easing the ridiculous passive loss rules of 1986. Perhaps give a tax break to home-buyers. Most important: Promote long-term jobs, growth and competitiveness by slashing capital gains tax rates and restoring a permanent and non-incremental 10 percent investment tax credit. Do not—repeat *not*—raise tax rates on *any* individual or business.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.



Stephen H. Axilrod
Nikko Securities

Whatever is done should be very temporary, since our basic need is to reduce the budget deficit sharply over time. That rules out income tax cuts, which have little effect if temporary, and also run the political risk of becoming permanent. An investment tax credit with a two-year life would be constructive, however. Also, public spending for infrastructure should be accelerated, including one-time grants to state and local governments which can use increased local revenues later in effect to "repay" the grants.



Laura D'Andrea Tyson
BRIE/University of California

The right prescription for both the long-run wasting-economy disease and the short-run recessionary headache is more federal spending on infrastructure and basic social needs. This would destroy last year's budget deal, but no matter, since one of its basic assumptions—the Soviet military threat—is obsolete. Down the road, a new budget package will be required to shift military savings to peaceful objectives, and higher, not lower, taxes will be needed to finance public investment and social programs.

The Underclass

by Isabel V. Sawhill



Violent crime, drug abuse, teen pregnancy, illiteracy, joblessness—these are the hallmarks of what has come to be called “the underclass.” Each new report of a drug-related murder, a street mugging, indiscipline in the schools, a youth gang terrorizing an entire neighborhood, or a welfare mother planning her eighth child leaves the average citizen wondering what has happened to basic values and to the institutions most responsible for transmitting them. Everyone has a theory, but no one really knows why the social fabric of certain communities has deteriorated so badly.

Defining the Underclass

Some claim that “underclass” is simply a new and more pejorative label for poor people. Conventional definitions of poverty, however, may miss what is most distinctive, most interesting, and most troubling about the underclass: its behavior.

Among the American people today, certain norms are widely held. Children are expected to study hard and complete at least high school. Young people are expected to refrain from conceiving children until they can support them, which usually means delaying childbearing until they have completed school and can draw on a regular salary. Adults are expected to work at a steady job, unless they are retired, disabled, or are supported by their spouse. Everyone is expected to obey the laws.

These are social obligations. Those who fulfill them are unlikely to be chronically poor. If they are poor despite having abided by the rules, society is much more likely to come to their rescue. This is and (with the possible exception of the 1960s) always has been the nature of the social contract. The problem is too many people are not fulfilling their end of the bargain; these people constitute the underclass.

To study the problem, The Urban Institute identified areas where dysfunctional behavior has become common. Specifically, these are neighborhoods that rank high (simultaneously) on school dropout rates, numbers of female-headed families with children, welfare dependency, and joblessness among adult males. Using this approach, we identified 880 underclass neighborhoods around the country that contained 2.5 million people, of which 1.1 million were poor.

Our analysis led to the following conclusions: First, the underclass is small. It is so small, in fact, that most poor people are not part of it; in 1980, for example, 29 million Americans lived in poverty, but we found only 1.1 million of them in underclass areas. Second, it is a heavily minority population—59 percent black and 12 percent Hispanic—yet less than 6 percent of the black population and less than one-fifth of the black poverty population live in what we have labeled underclass areas. Third, and most striking, almost two-thirds of the adults had not graduated from high school. Between 1970 and 1980 the number of people living in underclass areas grew more than threefold and, from everything we can tell, these trends have continued through the 1980s.

Why a Growing Underclass?

The reasons for the growth of the underclass remain somewhat elusive. The

major competing explanations (which are in no way mutually exclusive) are:

- Changes in the number and types of jobs available to inner-city residents: The growth of white collar jobs in the cities means that more urban jobs demand education, while the migration of manufacturing to the suburbs or to other countries has dried up opportunities for unskilled workers.
- The growth of alternative sources of income—such as welfare, crime, and hustling—that make regular work less necessary.
- A deepening culture of poverty associated with the increased isolation and relative deprivation of the poor in general and poor minorities in particular.

Crime, welfare, and hustling pay a lot better than the kinds of jobs that inner-city residents can get.

There is a tendency in some circles to focus exclusively on the lack of jobs. Yet the real source of the problem may be the low levels of education and literacy that put ghetto residents at the end of the hiring queue in the first place. Whatever jobs are available to such poorly educated people, moreover, must compete with alternative sources of income in the ghetto. Crime, welfare, and hustling pay a lot better than the kinds of jobs that inner-city residents can get.

An earlier study found that crime accounted for about one-fourth of the income received by inner-city minority youths. When asked whether a job or “the street” provided better economic opportunities, one-third favored the latter. Their answer undoubtedly reflects not only the availability of significant

opportunities to earn money illegally, but also a disturbingly accurate perception that the chance of being arrested, convicted, and sent to jail is very low.

The behavior that characterizes the underclass has to be understood, at least in part, as a response to these economic realities. But it is a vicious cycle in which the behavior in turn makes economic success less likely. The seeming inability of public schools to overcome the initial handicaps of children born into poor and often unstable families produces young people who can compete only for the most marginal jobs. Given their poor economic prospects, such adolescents find other outlets for their energies and other sources of status, including exploitative sexual relationships, early out-of-wedlock childbearing, and involvement in drugs and crime. The cycle may then repeat itself in the next generation. Thus, people are locked into the ghetto not just by their lack of opportunities but also by cultural factors.

Still, Americans typically believe that people can get ahead, despite economic and cultural constraints, through education and work and by drawing on community and family resources in hard times. This has in fact been the pattern for most immigrant groups.

Focusing on behavior may seem to imply that escape from the ghetto is a matter of personal choice. But some things are *not* a matter of choice. People cannot choose the natural endowments that they receive at birth, people cannot choose their early environment, people cannot choose their race or gender, attributes that still matter in American life. But within these parameters—and they can be quite confining—people do have choices. The objective of public policy should be to widen people's choices and to reward those who take responsibility for their own lives.

Policy Directions

Several things can be done. First, we should invest in children. Investing in children is expensive but may still be the most cost-effective way to break the

cycle of poverty and social dissolution that besets the underclass. Programs with records of success already exist, such as prenatal care, nutrition assistance, preschool enrichment, and compensatory education. It would cost \$10 to \$15 billion annually to expand such programs and to support more innovative local approaches, some targeted at underclass areas. Any such expansion would need to be combined with serious efforts to improve inner-city schools.

Providing support for families who want to move out of the ghetto is equally important. Substituting housing vouchers for public-housing construction would be sensible. So would more efforts like Chicago's Gautreaux project, which quietly, and after careful screening, moves inner-city black families from public housing projects to suburban neighborhoods where their rents are subsidized. Families should be selected partly on the basis of their commitment to work and to provide educational opportunities for their children.

Investing in children is expensive but may still be the most cost-effective way to break the cycle of poverty and social dissolution that besets the underclass.

Furthermore, we should replace the welfare system with income support that is more closely tied to employment. Many thoughtful analysts have criticized the current system and suggested reforms. Though the details vary, all would eliminate income transfers as a source of *long-term* support for families that are headed by an able-bodied adult. Most would emphasize the child-support responsibilities of absent parents. And most would provide additional assistance or subsidies to the working poor. The recently enacted Family Support Act incorporates many of their views. These efforts may not be enough

to stem the growth of the underclass, but they are steps in the right direction.

I would add to these efforts a stronger incentive for young people to complete their educations and to defer childbearing. Early childbearing harms the prospects of not just one generation but two. A variety of responses is needed. Sex education, more school-based clinics where contraceptives are available, and abortion all have a role to play, as does the deterrent effect on young males of stronger and more consistent enforcement of child-support obligations. There is currently no real reward, however, for those teenagers who defer childbearing. Indeed, the welfare system and the social norms in inner-city communities tilt in the other direction.

Some thought should be given to promising every teenager from an impoverished inner-city family a generous voucher that could be used for such approved purposes as getting a college education, vocational training, or on-the-job training in a community-service job.

Receipt of a voucher would be conditional on remaining childless and finishing high school with a reasonable academic record. The childbearing rule would include young men as well as women—though it would, admittedly, be more difficult to enforce among males who were determined to conceal their paternity. An all-out campaign that included the stick of child-support enforcement together with the carrot of a voucher could begin to improve current behavior patterns, especially if community leaders supported this objective.

None of these suggestions is guaranteed to work; most of them will be controversial. The task of reducing chronic poverty and the growth of the underclass is daunting. The overall objective should be to give people better choices than they now have, both by creating opportunities and by giving them a clearer sense of personal responsibility.

Excerpted from *The Public Interest*, Summer 1989. Isabel Sawhill is Senior Fellow at the Urban Institute.

Human Capital and the Productivity of the Labor Force

by Gary S. Becker



To many of you, capital means a bank account, 100 shares of IBM, assembly lines, or steel plants. These are all forms of capital in the sense that they yield income and other useful outputs over long periods. But I am going to focus on a different kind of capital. Schooling, computer training, medical care, and lectures on the virtues of punctuality and honesty are capital too in the sense that they improve health, raise earnings, or even add to a person's appreciation of literature over much of his or her lifetime. Consequently, it is fully in keeping with the capital concept as traditionally defined to say that expenditures on education, training, medical care, etc., are investments in capital. However, these produce human, not physical or financial, capital because you cannot separate a person from his or her knowledge, skills, health, or values the way it is possible to move financial and physical assets while the owner stays put.

The outstanding economic records of Japan, Taiwan, and other Asian economies in recent decades dramatically illustrate the importance of human capital to growth. Lacking natural resources—e.g., they import practically all their sources of energy—and facing discrimination from the West, these so-called Asian tigers grew rapidly by relying on a well-trained, educated, hard-working, and conscientious labor force.

The importance of human capital to an economy shows up clearly in the earnings advantages of greater educa-

tion. Many studies have shown that high school and college education in the United States greatly raise a person's income, even after netting out direct and indirect costs of schooling and after adjusting for the better family backgrounds and greater abilities of more educated people.

As several recent studies document, the monetary gains from a college education rose sharply during the 1980s to the highest level during the past fifty years. The earnings advantage of high school graduates over high school dropouts also increased. Talk about over-educated Americans has vanished, and it has been replaced by concern once more about the quality and quantity of education and other training.

Strengths and Weaknesses

The 1980s also saw the development of considerable concern about the international competitive position of U.S. industry and services, concerns that were stimulated by tough economic competition from a renewed Europe, and from Japan, Korea and other Asian countries, sluggish rates of productivity advance in the United States during the past fifteen years, a large drop in SAT scores, and the dismal performance of American high school students on international tests in mathematics. Many people believe that the education and other human capital of American workers is much worse than that of the Japanese, Germans, and other competitors.

Yet this conclusion is not correct, for there are many strengths as well as some glaring weaknesses in the quality of the American labor force. The United States has a superb university system and on the whole a good collection of colleges that offer varied programs. Many students come here from Japan and elsewhere for postgraduate studies, and a surprising number of foreign students are also enrolled as undergraduates.

The top 60 percent of high schools also do a satisfactory job. True, they are generally far less demanding than the top half of schools in Japan, Korea, and many countries of Europe. But almost all graduates of these U.S. schools go to college where they catch up to and often surpass students from other countries.

Another real strength of the United States, especially in comparison to Japan and even Germany, is the growing utilization of the human capital of women. Labor force participation of married women is low in both these countries, and women there do not readily advance to responsible positions.

Another real strength of the United States, especially in comparison to Japan and even Germany, is the growing utilization of the human capital of women.

Job opportunities for women in the United States at first improved slowly as they started to move up in business and the professions during the past several decades. But the trend accelerated sharply after the late 1970s. The ratio of the earnings of full time working women to men increased more rapidly since 1979 than during any previous period in our history, and women are becoming much more prominent in many highly skilled jobs. Improvements in the economic position of black women have been especially rapid, and they now earn just about as much as white women.

What then is the United States' human capital problem? It is the lower 30 percent or so of high school students, who either do not finish school (about one-fifth), or are in the bottom quartile of high school graduates.

The bottom third of the United States' male labor force has done very badly during the past 30 years. Since real spending per student in public schools trebled from \$1,500 in 1960 to near \$4,500 in 1990, how can we say that too little is spent on public education? Yet there is little question that the quality of education available in large cities like Chicago and New York deteriorated greatly.

Another key factor in the lower economic position of less skilled males is the deterioration in family life. Almost half of all black children are raised by a single parent, while divorce and separation takes its toll on many white children as well. There is a small but growing body of evidence that divorce and being raised by one parent especially reduces the achievements of boys.

Families divide their total spending on children between number of children and the amount spent per child. Differences among ethnic groups in the United States are fascinating. Groups with small families generally spend a lot on each child's education and training, while those with big families spend much less. Japanese, Chinese, Jews, and Cubans tend to have few children but they become well educated, while Mexicans, Puerto Ricans, and blacks have big families and the education of children suffers. (I should add that the Mormons are an interesting exception, for they have both very large families and high levels of achievement.) It should come as no surprise that children from the ethnic groups with small families and large investments in human capital typically rise faster and further in the United States' income-occupation hierarchy than do children from other groups.

What Can Be Done?

Several steps can increase the quality at the lower end of the labor force without requiring much additional public spending. The easiest action conceptually, although not politically, would be to reorient immigration policy to admit many more younger, skilled workers. Because they would have above-average

incomes, they would pay above-average taxes and make few demands on welfare, Medicaid, and other transfer programs.

Including religious-sponsored and other private schools in the voucher program would help break the monopoly of teachers' unions and public school bureaucrats.

There is no magic bullet to improve automatically the education received by inner city blacks and other disadvantaged groups. But greater competition for students from private schools would be a big help. This is why I support a system that would provide each student, especially each poorer student, with a voucher equal to the per capita expenditure by public schools. Students would be allowed to use their vouchers at private as well as public elementary and high schools. Including religious-sponsored and other private schools in the program would help break the monopoly of teachers' unions and public school bureaucrats. The average Catholic high school provides a much better education than the typical public school at about two-thirds the cost.

Vouchers would encourage more poorer students to finish high school, but no doubt many would continue to drop out. This is not to be lamented if other reforms help dropouts acquire skills that make them productive members of the labor force. Germany has a successful program that combines on-the-job training with classroom activities for over two-thirds of their students between ages sixteen and nineteen. Vouchers that would have gone to students if they continued in school can be well spent on a program that would give to dropouts computing and other skills valued by the modern American economy. Of course, not all dropouts would

benefit from such an on-the-job training-apprentice program. Still, this would help raise the productivity of the sector of the labor force most in need of aid.

The enormous changes in family structure during the past quarter of a century cannot be radically reversed. But the harmful effects on children can be reduced. The United States is wisely moving toward policies that force divorced fathers to make good on their child support obligations, and welfare eligibility should not be contingent on the father being absent.

Under present laws, welfare payments closely depend on the number of children and not at all on their quality. This should be altered to make the number of children less important. Instead, parents should receive larger grants if they enroll their children in head-start programs, if the children do well in school, if they are taken for health check-ups, and for other contributions to the quality of their children.

Finally, I believe it is not wise to discriminate against women who stay home to care for their children. It is questionable whether child care should be subsidized at all, but surely any subsidies should not be available only to working women. Programs that favor working parents create *artificial* incentives for parents to work rather than stay home to care for their young children.

These proposals do not require a lot of public spending; indeed, they are probably cheaper than the present inefficient programs. But they would help better prepare this country for the modern economic world with its emphasis on information and skills, and the stiffer competition from other countries.

This originated as the Adam Smith Address to the National Association of Business Economists, and is excerpted from *Business Economics*, January 1992. Gary S. Becker is a Professor of Economics and Sociology, University of Chicago, and Senior Fellow of Hoover Institution, Stanford University.

Potpourri Potpourri Potpourri Potpourri



I am amazed at the extent to which people ignore the fact that recessions are to be expected in America, and everywhere else. Mayors complain that the recession forces them to close the libraries, as if they had no responsibility for so managing the city's affairs in good times that the libraries could stay open in recession. Business executives complain bitterly about their losses in a recession and are not consoled by the reminder that there had been five or six good years—which they attribute to their own skills alone. Everyone complains in a recession about inability to meet obligations he incurred in good times as if there would never be another recession.

We have had nine recessions in the past forty-three years. You don't have to be, in today's cliché, a rocket scientist to figure out that you are going to encounter a recession within a period short enough to be worth thinking about. To say this is not to relieve the government of doing what it can to prevent or moderate recessions. But this effort will not be fully successful, and we ought to learn to live better with the fact that recessions do and will happen.

Excerpted from "Recessions Happen," by Herbert Stein, *The Wall Street Journal*, October 10, 1991.



What 1991 conclusively showed is that our society is vastly overcommitted. Despite spending cuts, 31 states raised taxes in 1991. Governments at all levels are caught between the demand for more services and less taxes. By itself,

strong economic growth (which would increase tax revenues) cannot bridge this gap. We simply cannot afford everything we want.

The upshot is that our politics are growing more selfish and spiteful. They focus increasingly on rewarding friends and punishing enemies—and not pursuing a common good. Economic frustration feeds another ugly trend: the rising preoccupation with race and ethnicity.

At its end, 1991 leaves us awash in self-doubt. It's a troubling legacy. Are we distracted from the year's gains by momentary frustration? Or do these frustrations signal the onset of more insecurity and disorder? These are good questions for 1992—and perhaps many more years.

Excerpted from "The Year of Sobering Up," by Robert J. Samuelson, *Newsweek*, December 23, 1991.



Isn't it ironic that—after complaining about the government's mismanagement of the \$600 billion savings and loan mess, Defense Department procurement of \$1500 coffee pots, and the muckraking television spectacle of a botched Supreme Court

confirmation—everyone instinctively turns to the Federal government to "solve" the problems of the health-care system.

Excerpted from "Next Week," by Jay N. Woodworth, *Bankers Trust Company*, November 8, 1991.





Courtesy of the
Rockefeller Archive Center

I Believe

by

John D. Rockefeller, Jr.

I believe in the supreme worth of the individual and in his right to life, liberty, and the pursuit of happiness.

I believe that every right implies a responsibility; every opportunity, an obligation; every possession, a duty.

I believe that the law was made for man and not man for the law; that government is the servant of the people and not their master.

I believe in the dignity of labor, whether with head or hand; that the world owes no man a living, but that it owes every man an opportunity to make a living.

I believe that thrift is essential to well-ordered living and that economy is a prime requisite of a sound financial structure, whether in government, business, or personal affairs.

I believe that truth and justice are fundamental to an enduring social order.

I believe in the sacredness of a promise, that a man's word should be as good as his bond; that character—not wealth or power or position—is of supreme worth.

I believe that the rendering of useful service is the common duty of mankind and that only in the purifying fire of sacrifice is the dross of selfishness consumed and the greatness of the human soul set free.

I believe in an all-wise and all-loving God, named by whatever name, and that the individual's highest fulfillment, greatest happiness, and widest usefulness are to be found in living in harmony with His will.

I believe that love is the greatest thing in the world; that it alone can overcome hate; that right can and will triumph over might.

This "personal credo" was first delivered publicly by Mr. Rockefeller in an address at Fisk University in May 1941.

Get Out Of That Rut

Oscar Wilde said,
"Consistency is
the last refuge of
the unimaginative."
So stop getting up
at 6:05.
Get up at 5:06.
Walk a mile at dawn.
Find a new way
to drive to work.
Switch chores with
your spouse
next Saturday.
Buy a wok.
Study wildflowers.
Stay up alone all night.
Read to the blind.
Start counting
brown-eyed blondes
or blonds.
Subscribe to an
out-of-town paper.
Canoe at midnight.
Don't write to your
congressman,
take a whole scout
troop to see him.
Learn to speak
Italian.
Teach some kid
the thing you do best.
Listen to two hours of
uninterrupted Mozart.
Take up aerobic dancing.
Leap out of that rut.
Savor life.
Remember, we only
pass this way once.

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The Continuing Battle Against Economic Nonsense

by Murray Weidenbaum



The flood of economic nonsense that inundates our society each day is both appalling and inexplicable. Sometimes I get the feeling there's a conspiracy afoot on the part of business, government and the public interest groups to keep the economics profession operating at full employment. But that notion doesn't hold water, because it's not in their self interest to keep economists working. What might be in their self interest is the idea that they can fool some of the people some of the time. If that's the reason, all we can do is to expose it regularly for the poppycock it is. I offer a few examples:

Business Nonsense. We can begin with business and the way so many of its executives refer to what economists call "competition." In labor markets, when other companies bid away workers by offering higher wages and salaries, such competition is called "pirating." In the markets where a company sells its goods and services, on the other hand, the preferred term is "price chiseling."

Both businesses and unions have their own specialized vocabulary for foreign trade. "Imports" are seldom mentioned; they are more commonly referred to as "unfair foreign competition." And what is the desired response? Is it "protection?" No no, that's too blatant. "Fair trade" sounds much better. After all, it is only fair that we force Americans to buy domestically produced products.

An alternative solution was suggested by Russell Baker of *The New York Times*. He noted that the Japanese auto industry had productive capacity far in excess of its domestic requirements, while the United States had far more lawyers than it needed. Baker recommended a simple swap: We would send Japan 100 lawyers for every 1,000 Japanese cars that enter the United States. As American attorneys entered the Japanese economy, he reasoned, that nation's productivity would decline. In contrast, the exodus of lawyers from the United States would contribute to a rise in the efficiency of our economy. Eventually, the economic competitiveness of the two nations would equalize. Baker felt so strongly about his plan that he suggested we start the process by sending the Japanese 100 lawyers on the cuff.

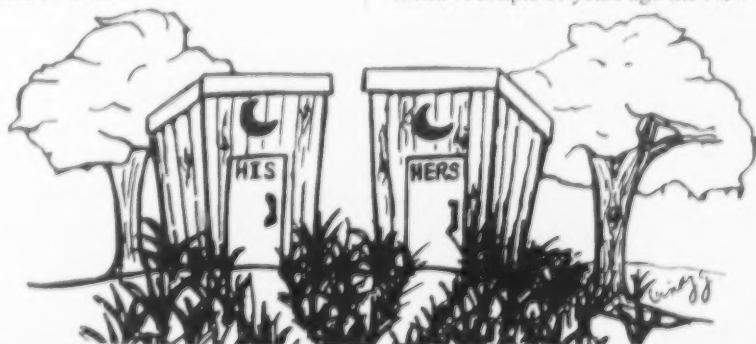
Government Nonsense. Consider first such programs as food stamps, Medicaid, and public housing. Predictably, we hear howls of outrage from their supporters anytime an effort is made to slow the growth of these distributions of "income in kind." But at the same time these supporters object strenuously to the idea that such income should be included when the government measures the number of people in poverty, on the grounds that a dollar of spending for these social programs does not generate a dollar of benefit to the recipients—i.e., that food stamps aren't worth their face value in cash.

One enthusiast for these social programs suggests that these items, should they be included in any measure of poverty, be discounted by 20 percent or even 40 percent. The cynic in me says that we have the makings of a deal here. Eliminate food stamps and other "payments in kind" and split the difference. Give the recipients cash equal to one-half of the government's current cost for these programs and reduce the budget deficit by the other half! The major complaints, I'm sure, would not arise from the recipients, only from the newly unemployed social workers and the professional advocates of the programs.

Let us now turn to regulatory nonsense, specifically the Occupational Safety and Health Administration. Did you hear about the OSHA rule that spittoons have to be cleaned daily? Is it true that OSHA made one little company build separate his and her toilets even though the only two employees were married to each other? Did OSHA really issue a regulation defining a hole, and another one on the color of exit lights? The answer is yes to each of these.

The Pentagon takes hundreds of pages of instructions to set the specifications for the purchase of a missile. That we might expect. But did you know it takes 14 pages to buy a fruitcake? That's right, it's Military Specification MIL-F-1499F.

Bureaucratic nonsense is not, of course, limited to the federal government. A couple of years ago the New



York City Board of Education sent a memo to thousands of teachers on the weighty subject of "Proper Handwashing." Here, as quoted in the *New York Times*, February 21, 1990, are the seven steps that are required.

- Remove rings and bracelets; place them in a safe area.
- Wet hands with warm, running water...necessary to carry away dirt and debris.

Did you know it takes the Pentagon 14 pages to buy a fruitcake? That's right, it's Military Specification MIL-F-1499F.

- Apply soap, lather well.
- Wash hands, using a circular motion and friction, for 15 to 30 seconds....
- Rinse hands well under running water. Point fingers down...so that the water drains from the wrist area to the fingertips.
- Dry hands well with paper towels and turn off the water, using paper towels instead of bare hands.

PIG Nonsense. Elsewhere in the nation, the self-styled public interest groups are usually referred to with respect. In Washington, however, they are just "pigs." Let us focus on the self-styled "corporate activists," the most famous of whom is Ralph Nader. Some time ago, a few of us criticized OSHA for issuing an especially dumb pamphlet on farm safety. When OSHA recalled its publication, Ralph attacked the agency for caving in. I'll let you decide for yourself about the usefulness of the pamphlet by reprinting a couple of paragraphs, as published in the *Omaha World Herald*.

Be careful around the farm... Hazards are one of the main causes of accidents. A hazard is anything that is dangerous.

Be careful when you are handling animals. Tired or hungry or frightened cattle can butt and trample you. Be patient, talk softly around the cows. Don't move fast or be loud around them. If they are upset, don't go into the pen with them.

Economists' Nonsense. Let me end with a parody of a group I have ignored to this point, economic forecasters. Here's what their speeches sound like:

Banking figures show an easing of the rate at which business is easing off. This can be taken as ample proof that there's a slowing up of the slowdown. Now, to clarify that, it should be noted that a slowing up of the slowdown is not as good as an upturn of the downturn. On the other hand, it's a good deal better than either a speedup of the slowdown or a deepening of the downturn. Also, it suggests that the climate is about right for an adjustment of the readjustment to interest rates.

Turning specifically to interest rates, we find a very definite decrease in the rate of increase. This clearly shows there should be a letting up of the let-down. Of course, if the slowdown should speed up, the decrease in the rate of increase would turn into an increase in the rate of decrease.

And finally, the inflation of the recession would turn the recession into a depression, while a deflation in the rate of inflation would give the impression of a recession of the depression. (I hope you got all that—because there'll be a test later!)

Murray Weidenbaum is Director of The Center for the Study of American Business, Washington University of Saint Louis.

The Costs of Protectionism

Restrictions on imports of textiles, apparel, and nonrubber footwear have been a recurring and nagging issue over the past decade. The Congressional Budget Office (CBO) has studied the history of the economic health of the three industries and the economic effects of the major proposals for changes in protection and concluded that tariffs and import quotas are a costly and inefficient means of preserving jobs in these industries.

Estimates of the annual costs to consumers of current and proposed restrictions are generally in the range of \$39,000 to \$74,000 for each job they retain in the textile and apparel industries and higher for jobs retained in the nonrubber-footwear industry. Most estimates of the annual net costs of these restrictions to the economy (the amount by which the costs to consumers and the government exceeded the benefits to U.S. firms, workers, and the government) are in the range of \$9,000 to \$38,000 for each job retained in the textile and apparel industries. Estimates of costs in the nonrubber-footwear industry are higher.

Indeed, the estimated consumer costs are all higher than the average annual earnings of the workers who hold the jobs, and most of the estimated net welfare costs are also. Consequently, it would generally be more efficient for the government to allow the jobs to disappear and compensate any displaced workers who cannot find equivalent work.

Excerpted from a summary of "Trade Restraints and the Competitive Status of the Textile, Apparel, and Nonrubber-Footwear Industries," a December 1991 study by the Congressional Budget Office, U.S. Congress.

Conference Board Stat File

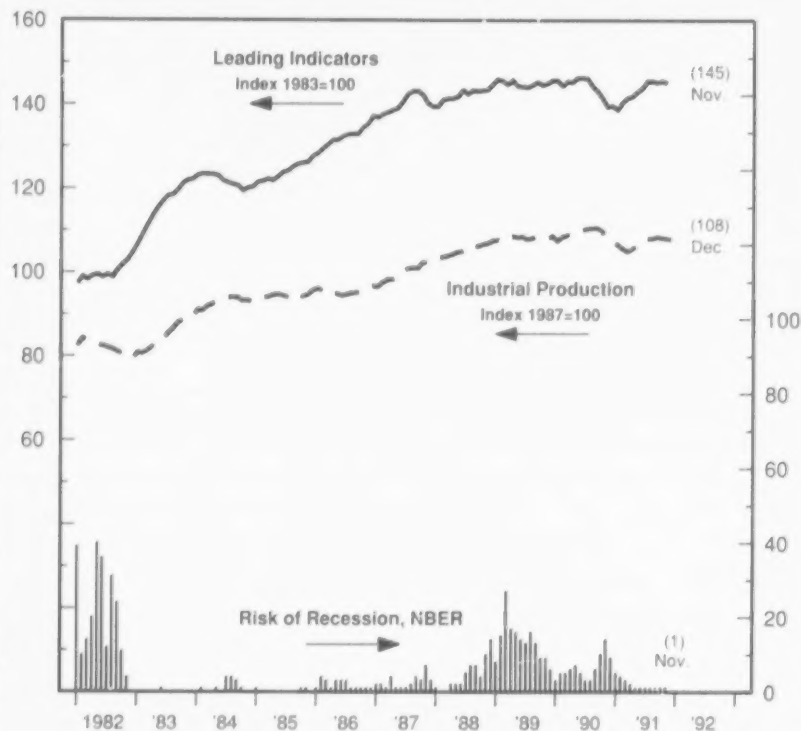
Still Muddled

The economic outlook is still muddled. The optimists can't explain away the sour state of consumer expectations (page 14) and the pessimists can't explain away the stock market. The GDP growth rate came in at 0.3 percent for the fourth quarter and, in view of the lack of direction in the leading index (below), growth seems likely to remain in that general range for the current period. Inflation continues to subside slowly (page 13).

In Washington it's politics as usual, as the President and Congress fight to sprinkle goodies among their constituents in this election year. Tax cuts and additions to spending are on their way, but the amounts and the impact will probably be limited. The important action is on the monetary side, where the Federal Reserve has made clear its resolve to stimulate forcefully. Even with no further action by the Fed, slow economic expansion is the best bet for the spring months with an incremental momentum taking hold from there. (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

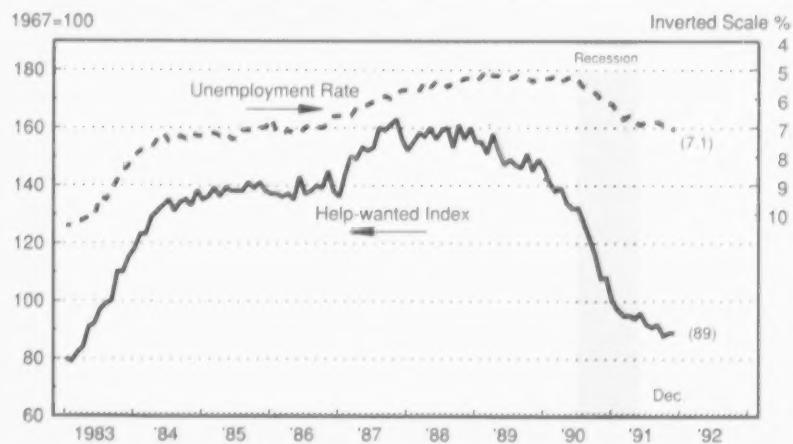
Early Warning Indicators

Early warning indicators say the U.S. business cycle is inert.



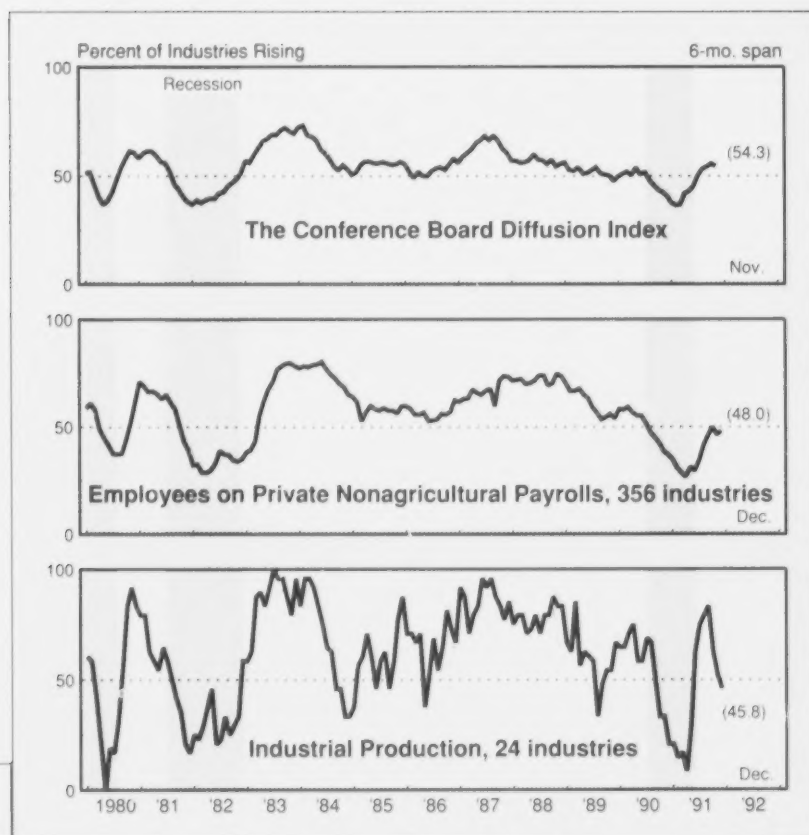
Help-Wanted Advertising and Unemployment

Labor market indicators continue weak.



Conference Board Stat File

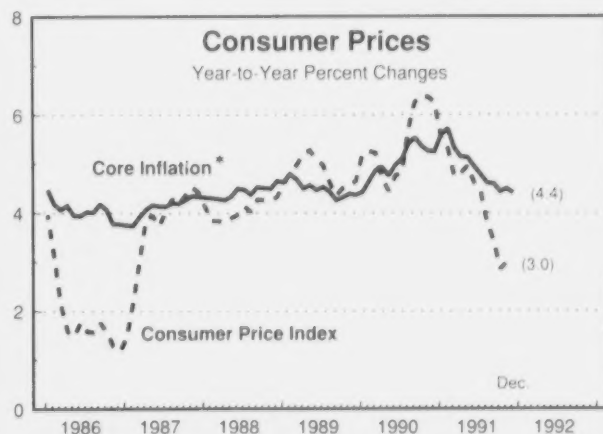
Indexes of Economic Momentum



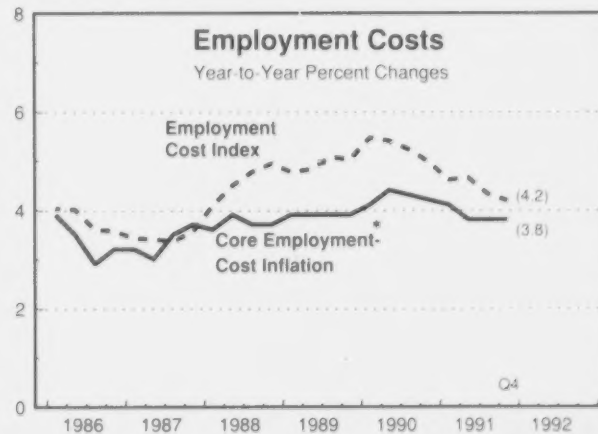
Momentum back in neutral.

Core inflation has slowed, but the rate is still no lower than the average of the past 6 years.

Inflation Fundamentals



* Core Inflation = CPI excluding food at home and energy.



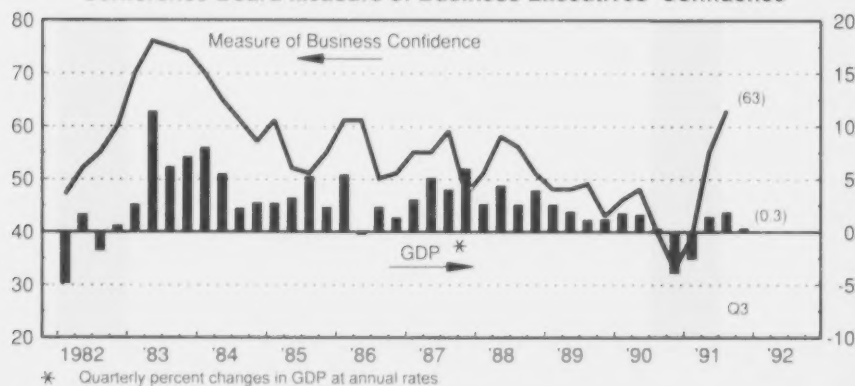
* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

Confidence



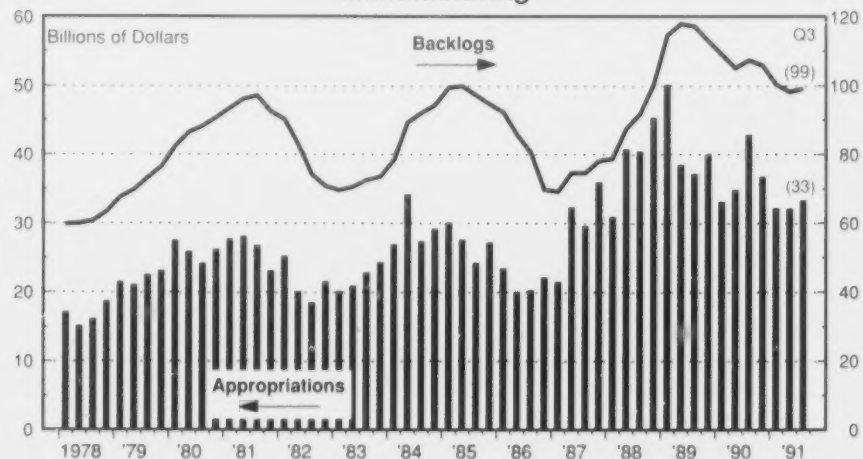
Conference Board Measure of Business Executives' Confidence



Consumer expectations continue very depressed.

Investment Intentions

Conference Board Capital Appropriations Manufacturing



Manufacturers' capital spending plans holding up fairly well.

Inside the Crystal Ball

	UCLA	MERRILL L.	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN - RSQE
Date of Forecast	Jan.	Dec.	Jan.	Jan.	Jan.	Jan.	Jan.	Jan.	Jan.	Jan.	Jan.

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	%		
Actual	1991 2Q	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	2Q 1991	Actual
	3Q	1.8	1.7	1.8	1.7	1.8	1.8	1.8	1.8	1.8	1.8	1.8	3Q	
Forecast	4Q	-0.2	-1.0	-0.7	-0.7	0.2	0.9	1.4	0.0	0.3	0.5	0.5	4Q	Forecast
	1992 1Q	-1.0	-1.0	-0.1	0.7	0.0	1.1	2.2	0.7	-0.5	-0.5	1.1	1Q 1992	
	2Q	1.4	2.4	3.8	1.3	2.5	1.5	3.4	2.4	2.8	2.8	2.8	2Q	
	3Q	2.9	3.4	4.4	3.0	3.3	2.5	3.9	3.8	4.1	3.5	4.2	3Q	
	4Q	3.3	3.1	4.4	2.9	2.9	2.7	3.6	3.6	4.6	3.6	4.1	4Q	
1993 1Q	3Q	3.4		3.4	3.2	2.9	1.8	3.3	3.2	4.1	2.9	4.4	1Q 1993	
	2Q	4.1		3.5	3.8	3.0	2.1	2.1	3.0	3.4	2.9	3.3	2Q	
	3Q	3.3		3.3	4.1	2.9	2.6	2.4	3.0	2.5	3.0	2.2	3Q	
	4Q	2.6		3.3	3.7	2.5	2.3	3.9	3.2	1.9	2.9	1.9	4Q	

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Forecast	1991 4Q	3.1	3.4	3.3	3.2	3.5	3.0	2.4	3.3	3.1	3.0	3.0	1991 4Q	Forecast
	1992 4Q	1.8	3.8	3.6	2.8	2.9	2.3	3.8	2.6	3.3	2.2	3.0	1992 4Q	
	1993 4Q	2.4		3.6	3.3	3.3	3.3	2.8	2.9	3.1	3.4	3.0	1993 4Q	

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual	1991 2Q	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	2Q 1991	Actual
	3Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	3Q	
Forecast	4Q	7.8	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.8	4Q	Forecast
	1992 1Q	7.5	7.7	7.3	7.4	7.3	7.5	7.7	7.4	7.6	7.2	7.5	1Q 1992	
	2Q	7.6	7.8	7.3	7.4	7.1	7.5	7.9	7.4	7.5	7.1	7.3	2Q	
	3Q	7.6	7.9	7.2	7.6	7.1	7.5	7.9	7.5	7.6	7.2	7.2	3Q	
	4Q	7.7	8.0	7.3	7.7	7.2	7.8	7.9	7.6	7.7	7.4	7.1	4Q	
1993 1Q	2Q	7.8		7.4	7.8	7.3	7.8	7.9	7.5	7.9	7.5	7.3	1Q 1993	
	3Q	7.8		7.4	8.0	7.4	8.0	7.8	7.5	7.9	7.6	7.2	2Q	
	3Q	7.9		7.5	8.2	7.5	8.0	7.8	7.4	8.1	7.7	7.1	3Q	
	4Q	8.2		7.5	8.4	7.6	8.0	7.8	7.4	8.4	7.8	7.0	4Q	

Unemployment Rate

(Percent, quarterly)

Actual	1991 4Q	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	4Q 1991	Actual
Forecast	1992 4Q	7.5	6.7	6.6	7.0	6.8	6.9	6.6	6.8	6.7	7.2	6.8	4Q 1992	Forecast
	1993 4Q	6.8		6.2	6.3	6.4	6.9	6.3	6.0	6.0	6.9	6.2	4Q 1993	



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Editor's Note

This month, more than usual, our stories are devoted to issues that face the economy over the long term. First, our Colloquium addresses the question directly, that is, what we can do to persuade Americans to take a longer view when making economic decisions. Then Walter Olson looks at the trend toward using litigation as a tool of public policy. (I hope readers will understand that although this article takes a negative view of excessive litigation, we are not engaged in "lawyer bashing." After all, some of my best friends are lawyers.)

Next, Ed Banfield examines the tendency for the growing middle class to moralize about and try to reform the American political system. I'm sure many readers will, as I did, recognize themselves (in part at least) in Banfield's description. Then you'll find a very quotable quote from Allan Meltzer. And, as always, we conclude this issue of *Economic Times* with the Stat File and Crystal Ball.

Ed Fiedler

Maxim of the Month:

How is the world ruled and how do wars start? Diplomats tell lies to journalists and then believe what they read.

Karl Kraus

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A Billion A Day—Who, Me Worry?

The budget deficit is headed for new heights this year, more than \$1 billion per day. But with the economic recovery odiously feeble and politicians focusing on such re-election pleasantries as middle class tax cuts, worries about the budget deficit have been forgotten. Is this attitude justified? Or are the deficits worth worrying about?

The answer is a decisive *yes and no*. If your focus is on 1992 and 1993, and you're worried that the mammoth borrowings to finance the deficits will send either inflation or interest rates surging to threatening levels—well, in that case, no, don't worry. No need for anxiety, because when the economy is weak there's plenty of unused capacity available in both the product and credit markets to finance big deficits without putting pressure on either inflation or interest rates.

But if your horizon is not just a year or two, but is rather the next decade or two, then the massive deficits we pile up year after year are indeed worrisome. The chart below shows recent deficit projections made by the Congressional Budget Office (with minor adjustments by The Conference Board) covering the next ten years. These projections assume that the 1993-94-95 spending limitations incorpo-

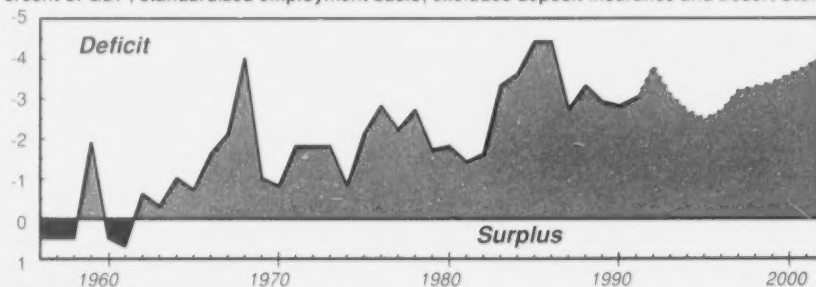
rated into the Budget Enforcement Act of 1990 (which require further cuts) are maintained. They assume no tax cuts. And they assume no new medical programs or any further expansion of existing programs. Consequently, chances are fairly high that the deficit will prove to be larger than the CBO now projects. Yet even with these conservative assumptions, the deficits do not disappear after a few years—as once was typical. Instead, they continue in the neighborhood of 3 percent of GDP through the middle of the decade, and then climb gradually to about 4 percent.

What damage do these deficits inflict? Every dollar of private saving needed to finance the deficits is a dollar not available to equip our labor force with the more sophisticated tools needed to improve productivity and raise the living standards of future generations.

Even before the deficits became large and chronic, the United States was a low-saving, low-investment, slow-growth economy. If now the budget deficits preempt a major fraction of our limited net saving and investment decade after decade, the worry is that we may become a still slower growth economy, possibly even a no-growth economy.

U.S. Budget Surplus and Deficit, 1956-2002

(Percent of GDP; standardized employment basis; excludes deposit insurance and Desert Storm)



Source: OMB, CBO and TCB estimates.

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Colloquium: Taking the Long View

Background:

We Americans are accused of being habitually shortsighted. When making economic decisions—whether as consumers, workers, managers, investors, or politicians—we rarely take the long view. This pervasive, structural, near-horizon orientation is, in turn, blamed for our slim levels of saving and investment, high cost of capital, adversarial workplace relationships, and other economic conditions that corrode our international competitiveness and stunt our long-term growth in living standards.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

Question:

What, if anything, should be done to encourage Americans to take a longer view when making economic decisions?



James Tobin
Yale University

Maybe nothing *can* be done. TV culture glorifies winning games, driving fast, living high. Scattered suggestions: limit tax deductibility of advertising; tax institutional portfolio churning; lower capital gains taxes and raise loss offsets with duration of holding; keep CEOs off each others' boards; tax gasoline \$1 a gallon; recruit ex-Soviet scientists and engineers; let students "pay later" for higher education proportionally to their career incomes.



Isabel V. Sawhill
The Urban Institute

Americans are not by nature, myopic. But the way we govern ourselves is. The average citizen, whether as voter or as shareholder, cannot make informed decisions on the complex issues of national or corporate governance. These decisions must be delegated to our elected representatives—whether in Congress or on corporate Boards of Directors. We should look hard at the governance process in both areas; it needs strengthening.



Murray L. Weidenbaum
Center of the Study of American Business

Most Americans take as long (or short) a view as makes sense to them. Unfortunately, many of the groundrules set by government encourage a short-term orientation. Shifting the federal revenue structure from taxing income to taxing consumption would stimulate more saving and investment, while leaving the choice to individuals and enterprises. Moreover, it is laughable for the world's biggest dissaver (Uncle Sam) to tell citizens to think more long-term and consume less.



Robert G. Dederick
The Northern Trust Company

If Americans don't want to take a longer economic view, that's their business. I am aware of no law to the contrary. If, in the end, they don't like the results, they no doubt will change their ways without any help from economists. Since there *does* appear to be a law, though, that requires economists to impart wisdom on all subjects nowadays, I will suggest one obvious approach: the removal of the various, well known tax-law-induced impediments to saving and investment.

The "Invisible Fist" of Litigation

by Walter Olson



Stuck in rush-hour traffic? Kept awake by teenagers drag-racing down Main Street? Fender dented by a careless driver at the mall? In 1976, Beverly C. Moore, Jr., a "public interest lawyer," and Fred Harris, former Democratic senator from Oklahoma and presidential-candidate-to-be, proposed an ultimate if drastic answer to these familiar car-related woes: file a lawsuit—not against your fellow drivers, but against Detroit (and, these days, Yokohama) for not designing automobiles that would prevent these ills. The way to make society safer, cleaner, and quieter, they argued, was to make business enterprise legally responsible for the full measure of risk, grime, and distraction entailed by its output.

If the automobile industry were saddled with an annual damage liability of perhaps \$100 billion for accidents, air pollution, noise, congestion, and highway and traffic-control costs, and were forced to raise its prices by that amount, it would have no choice but to redesign its vehicles to minimize these costs and their associated liabilities.

The beauty of the idea, in their view, lies in its harnessing of market mechanisms to solve otherwise intractable social problems. After all, "if the profit motive helps reduce the costs of the beneficial products of our economy, it can be enlisted to reduce the harmful by-products." What could be more sensible?

Bizarre as it may seem, Moore and Harris's idea should not be ignored. It

serves as a specimen, admittedly extreme, of thinking that is routinely invoked to justify not only lawsuits against manufacturers but lawsuits of almost every other kind as well.

It might be called the invisible-fist theory. In Adam Smith's famous account, self-seeking butchers and bakers are led as if by an invisible hand to further the general welfare; private striving leads to public benefit. The modern legal counterpart holds that private quarreling leads to public benefit. The more scrutiny the courts apply to the conduct of others, the better everyone will behave. In short, the more suits filed, the better off the world will be.

The Attractions of Deterrence

Moore and Harris concisely express the theory's major premise when they write that the main purpose of a system of civil litigation is "deterrence—i.e., discouraging the injurious conduct that gives rise to litigation." By imposing liability on people or institutions that could have prevented harm, society gives them "a profit incentive to reduce the magnitude of the harms they cause." In reality, of course, many if not most such lawsuits arise from situations where the proper focus of control over the harm is not clear. If someone buys household lye and then inadvertently hurts himself with it, for example, it is far from clear that he was harmed, without agreeing or consenting, by the manufacturer. Arguably the real imposition arises only afterward, in the opposite direction—when the buyer uses the courts to recover money from the lye maker.

In any case, the deterrence premise is offered to justify virtually every kind of lawsuit in American courts today. The victim mugged in a parking lot or dormitory sues the supermarket or university for "negligent security"—not, ostensibly, to make a fast buck, but to ensure

that such safety lapses never happen again. The bartender or private party-giver who lets a guest drive away tipsy gets sued to encourage other hosts and servers—though not other guests, of course—to be more careful in the future. Tobacco liability, it is said, will drive up the price of a pack of cigarettes to reflect the full harm that they do. A spokesman for the Center to Prevent Handgun Violence calls for making gun manufacturers liable to shooting victims so that "those who profit from dealing in these death machines...pay for their inevitable social cost."

Hardly anyone makes it clear, however, exactly where the boundaries to this theory lie—if anywhere. Moore and Harris had a list of twenty-four broad categories of ills to which human flesh is heir, and of corresponding business and professional defendants whom they would require to fork over cash on the barrelhead in compensation.

The usual suspects—tobacco companies, polluting industries—are, of course, in evidence. But Moore and Harris would also make producers of sugar- and fat-laden foods legally responsible for a wide range of maladies, from tooth decay to adult-onset diabetes. Automakers would be tagged with the cost of every highway collision. The makers of ordinary household products involved in accidents, from beds to bicycles, would share a similarly expensive fate.

What about mishaps that arise from user carelessness or deliberate misuse? Or the inevitable side effects of, say, valuable prescription drugs? No reason for business to be let off the hook in either case, said Moore and Harris. If drug makers were made fully liable for overdoses and side effects, for example, "it can be safely predicted that the industry would develop effective mechanisms to ensure that many or most such cases are in fact avoided."

Whatever might happen to every other industry in the squabbling over these issues, one would be sure to thrive: the litigation industry. By even a conservatively, the annual redistribution would be well over a trillion dollars. The billable hours for the legal profession would also have mounted fast, as would the contingency fees.

Learning to Love Litigation

In recent years we have begun to conceive of lawsuits primarily as vessels for "deterrence," and policy making. This is a significant departure from the past. Our legal tradition used to view lawsuits as an evil, at best a necessary evil. Litigiousness was a form of bullying.

The law accordingly used to maintain barriers that deterred people from bringing anything short of a strong and definite grievance to court. Ethical controls discouraged lawyers from "stirring up" litigation. Procedural rules assigned many costs of litigation to those who wanted to initiate or prolong it, rather than to its targets alone. Evidence rules discouraged doubtful, speculative claims. Once litigation was reconceived as a productive, socially beneficial activity, these rules ceased to make much sense. If a product is wholesome and desirable, how better to get it churned out in quantity than by freeing its producers from archaic restrictions? So American legal reformers set about to deregulate the practice of suing people.

Rules against advertising and solicitation by lawyers were eliminated. Parents of children with birth defects were soon being approached by attorneys who urged them to sue doctors and hospitals; crime victims were contacted with the happy news of their right to sue businesses for "negligent security." As early as 1975 one new legal ethicist was writing of a "professional responsibility to chase ambulances."

The trend encouraging litigation was broad in scope. Civil procedure was revamped to make it easier to file a suit and harder to get one dismissed. Other

changes shifted burdens from those wishing to tie up others in court to those wishing to stay out. Meanwhile, the rewards for suing and penalties for getting successfully sued—in the form of damages—were being raised dramatically. More chances were created for plaintiffs to recover triple or punitive damages.

*The invisible-fist theory
says: The more suits filed,
the better off the world
will be.*

Class actions, Moore and Harris's preferred vehicle for suits against businesses, were likewise helped along by various changes. In many of these suits lawyers emerged as the real players, with clients reduced to figure-head roles. Soon "private attorney general" and "citizen suit" statutes began to authorize lawyers to wage suits purely and openly on their own behalf, for ideology, profit, or both. The invisible-fist theorists found this a welcome streamlining of the deterrence process. The point, after all, was not so much to give pleasure to any particular client as to give pain to the defendant.

The Costs

Litigation is enormously costly. When people file lawsuits or resist valid suits, they dump terrible costs on their opponents. The financial costs of response, often thoroughly ruinous, are just the beginning. The suspense and uncertainty of litigation are destructive in themselves, as litigants learn when they apply for loans or are forced to sell their homes at distress prices. Lawsuits tend to be miserable experiences on a personal level as well, setting people against each other in bitter acrimony. Privacy is sacrificed as parties answer probing questions under oath.

Among the costs of courtroom processes should also be reckoned their

error rate. Litigation over the drug Bendectin, used safely for decades against morning sickness in pregnancy, illustrates this. Leading scientific authorities agree that Bendectin does not cause birth defects. Most American courts have agreed, but a few juries have voted the other way. The makers of Bendectin, observing this inconsistency, offered well over \$100 million to settle a 1,000-case consolidated action. (Dissident plaintiffs' lawyers torpedoed the offer and insisted on going to trial, where they lost outright and got nothing.) That \$100-million offer represented in large measure the chance that juries would misunderstand the facts about the drug. If the stakes are high, an entire litigation industry can prosper simply by speculating on the likelihood of the errors occasionally committed by juries.

Other countries' legal systems seek to curb the heedless imposition of these costs. But because America by and large fails to recognize a right to redress for wrongful litigation, most prevailing plaintiffs suffer along with most prevailing defendants. Many valid, airtight claims trade for less than their dollar value on the settlement market and others cannot economically be pressed at all. Meanwhile—in seeming, but not real, paradox—plaintiffs with weak, speculative cases can frequently win large settlements, mostly because of defendants' eagerness to avoid being tied up in court.

What has emerged quite predictably from all of this is an industry devoted to identifying chances to sue and maximizing profits from the resulting suits. Collectively, the industry has cyclical ups and downs like any other, but over the long run it careens toward maximum output. The "invisible fist" theory incorporates no limits.

Excerpted from *The Public Interest*, Spring 1991. Walter Olson is senior fellow at the Manhattan Institute and author of *The Litigation Explosion: What Happened When America Unleashed the Lawsuit* (E.P.Dutton/Truman Talley Books).

The Middle Class Reformer and American Government

by Edward C. Banfield



In my view, the feature of the American political system that is most useful in explaining it is the extreme fragmentation of formal authority. Many consequences follow this, the most obvious perhaps being widespread participation in the day-to-day conduct of government.

In other democracies it is taken for granted that the people will give or withhold consent at intervals and that in the meantime the government, so long as it has a working majority in parliament, has the exclusive power to make and implement plans. Rule by the people, by contrast, necessitates creating a sufficient coalition of powerholders issue by issue.

In such a system, the function of the politician is to find the terms on which the many holders of bits and pieces of power will collaborate; he is a broker who arranges deals in this way. Obviously his talents and skills are very different from those of the statesman, whose function is to discern the content of the common good and to devise strategies for securing it. Although they are analytically unlike, the politician and the statesman may be concretely the same: no one will doubt that Lincoln, for example, was both a politician and a statesman. It will be seen, however, that it is in the nature of rule by the people (as opposed, say, to parliamentary democracy) to make more use of politicians than of statesmen.

Rule by the people allows no place for the making and carrying out of com-

prehensive, internally consistent plans. Planning in this sense is incompatible with the character of a highly fragmented political system. To be sure, the universities give degrees in planning, and there are countless governmental planning bodies, most of which produce documents called plans. When government acts, however, it is not on the basis of these plans; rather it is on the basis of compromises that have been reached among competing interests. Government by compromises often leads either to stalemate or to outcomes that are indefensible from a public standpoint. Such outcomes often impose very high costs upon those most affected, and, what is worse, they raise doubts about the ability of the government to meet emergencies of a kind that require an internally consistent line of action.

Taking the pluses and the minuses into account as best I can, it seems to me that government by compromise is a luxury that democracy can and should afford except possibly in the gravest emergencies of war.

The citizen is rarely a very competent ruler. As Joseph Schumpeter remarks in *Capitalism, Socialism, and Democracy*, when he deals with public as opposed to private affairs, the individual's sense of familiarity and responsibility is usually much reduced. Acting without any immediate responsibility for the outcome, the citizen is apt to show naivete in three contexts that are of particular interest here.

First, he will probably favor any changes that are likely to make the political system more democratic. The democratic ideal allows for the exercise of only such power as arises from reasonable discussion about the common good in which all participate; all other sources of power are incompatible with the ideal and should therefore (the citizen is apt to think) be eliminated. The

ideal, however, is unrealizable: government cannot operate solely on the basis of reasonable discussion, and the elimination of illicit sources of power will, if carried far enough, render it ineffective.

Second, the citizen is likely to overlook the systemic character of institutions and to suppose that an intended change can be effected without giving rise to consequences that are neither intended nor wanted. A political system, however, is a set of relationships such that a disturbance at one point in the system is felt throughout it and may change its entire character. It is naive for a reformer to think that he can change one feature of a system without affecting others or to ignore the real possibility that in improving matters in one respect he may unwittingly make them worse in other, perhaps more important, aspects.

Third, the citizen is prone to assume that the morality appropriate to personal relations (with family, friends, neighbors, and business associates) is also appropriate to affairs of state. I contend that this is mistaken simplicity.

The growing American middle class, i.e., those persons who expect to send their children to college or who have attended college themselves, has a special ethos. Whether because of their interest in formal education or for other reasons, middle-class people tend to take more account of the future than do working-class people, to have more interest in public affairs, to be more willing to make small sacrifices of private for public interest, and to participate to a greater extent in public affairs.

One might infer from this that continuing "middle classification" will eventually immunize public opinion against the kinds of naivete that I have described. On the contrary. In my judgment, the middle class, especially its higher reaches, has a stronger attachment to the democratic ideal than does

the working class and a more unquestioning faith that good intentions will produce good consequences. Confident that goodwill and expertise can solve, or at least alleviate, all social problems, a middle-class person is likely to feel a positive obligation to undertake reform no matter what the costs.

The typical middle-class reformer has undue confidence in the use of social science and of organized knowledge generally. He fails to see that the problems of society are at bottom moral and political, arising from the differences of opinion as to what is and, especially, as to what ought to be. Insofar as such problems are solvable, it is by discussion, bargaining, and struggle; to try, as the reformer is prone to do, to substitute information for wisdom is likely to exacerbate rather than alleviate these problems, which arise from the nature of man and in one form or another are in-

eradicable.

While failing to recognize the essentially moral nature of social problems, the reformer is given to moralizing about them, and this is worse than futile. The moralizer urges as a basis of action moral principles or standards that cannot be applied in the circumstances in which action must be taken: he averts his gaze from the facts that constitute the problem while advocating what, if the situation were different, would be a right course of action.

It should be emphasized that the reformist impulse exists among conservatives as well as liberals. Even among conservatives of the libertarian variety—perhaps especially among them—there is a distaste for politics and compromise, a persistent effort to substitute for it a system of rules adherence to which will produce “welfare” (“the public interest”), and a characteristic confidence

in the efficacy of information as opposed to wisdom. Like the liberal, the conservative reformer wants to break up concentrations of government power. Ironically, the efforts of both lead, albeit in somewhat different ways, to increasing the concentrations.

In my view, the reformer-moralizer constitutes a serious problem for rule by the people. For one thing, he recommends measures that cannot work and are apt to make matters worse. For another, he blames “society” for its failure to do the undoable and by so doing he creates disenchantment, cynicism, and mutual distrust; in short, he undermines the consensual basis of the society.

Excerpted from the author's introduction to the second edition of *Here the People Rule: Selected Essays*, The AEI Press, American Enterprise Institute, Washington, D.C. Edward C. Banfield is professor of government emeritus, Harvard University.

Quotable Quote

Stimulate Growth, Not Just Recovery by Allan H. Meltzer



Although there are regions of the country with serious distress, our main economic problem today is not the current recession; it is the slow average growth of per capita income for the past twenty years. Average compensation per hour, adjusted for inflation, increased only 3 percent in the sixteen years ending in 1989, after increasing more than 30 percent in the previous sixteen years. The principal reason behind the slow growth of middle class income is the slow growth of productivity.

Several bills recently introduced in Congress seek to change the income distribution by reducing taxes on middle income families. These proposed tax changes reflect a misperception of the problem. To raise incomes permanently for the middle class, and all other productive people, we must raise productivity to increase output and incomes. There is no magic pill or quick fix to do that. Productivity growth in the aggregate depends on investment in physical capital and in education. People with better tools and equipment produce more. People with better education think of ways of improving either the tools or the way they are used.

Tax policy can increase productivity by increasing investment, which we do by raising the after-tax return to investment. One thing we could do is replace taxes on income with taxes on spending. That would remove taxes from saving and thus encourage saving and productive investment. Substitution of a spending tax for the personal income tax would leave the budget deficit unchanged. Over time, higher investment would raise productivity, income, spending, and tax revenue.

An alternative would be to allow business to take all investment spending as a deduction from income. This immediate write-off of capital costs would encourage development of old and new capital-intensive industries. The jobs that would be created would have higher productivity, thereby raising the growth rate of family income.

The administration and the Congress should opt for the long-term solution, not the quick fix.

Excerpted from testimony delivered before the U.S. House of Representatives Committee on Ways and Means, December 17, 1991. Allan H. Meltzer is visiting scholar at the American Enterprise Institute and Olin Professor of Political Economy and Public Policy at Carnegie Mellon University.

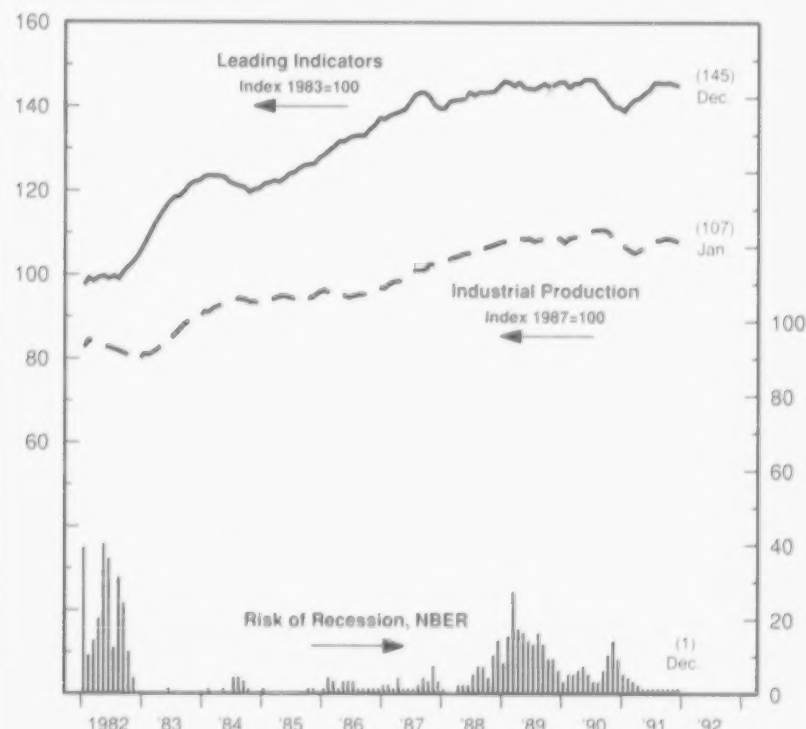
Conference Board Stat File

Decisively Ambiguous

Again this month the statistical series charted on these pages present a mixed picture, fairly well balanced between optimism and pessimism. At latest count the inflation numbers have improved further, but the consumer expectations index has dropped still deeper into recession territory. The most recent report on executive confidence, however, remains above the midpoint, a reading that was confirmed at February meetings Conference Board economists attended with groups of CEOs, CFOs and business economists. The tenor of those meetings, although not optimistic, conflicted markedly with the deep gloom of the general public. The executives left the impression that "we can live with this" rather than "fear of falling." On balance, however, the economic signals remain decisively ambiguous. (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331).

Early Warning Indicators

Cyclical indexes giving off no signal at all.



Help-Wanted Advertising and Unemployment

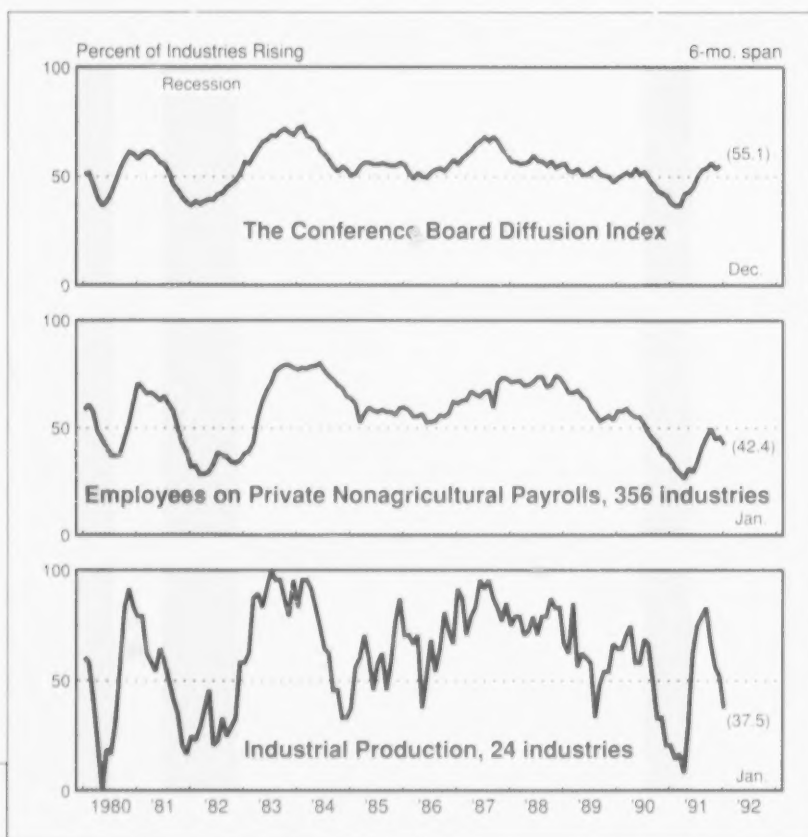
Labor markets still weak.



Conference Board Stat File

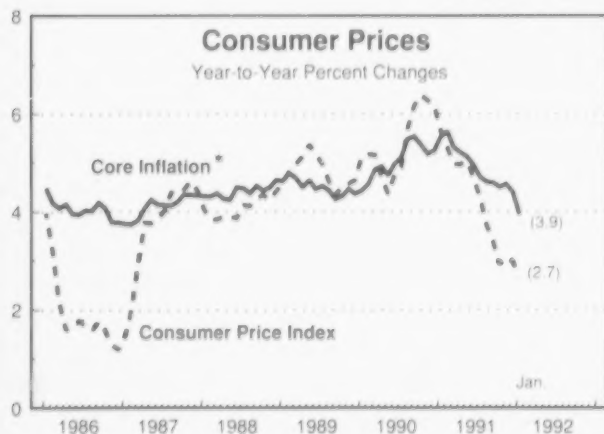
Indexes of Economic Momentum

Momentum slowing.

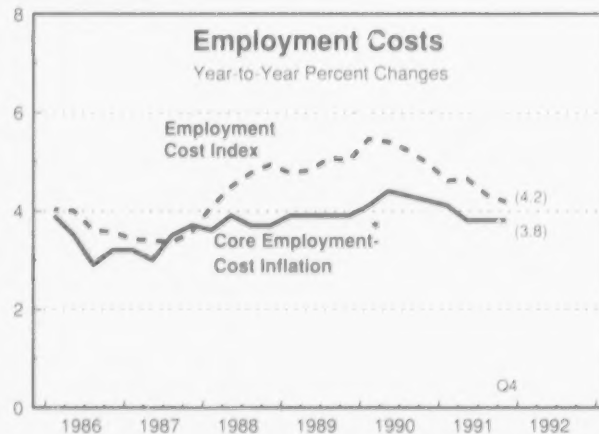


Core price inflation below 4 percent for the first time in years.

Inflation Fundamentals



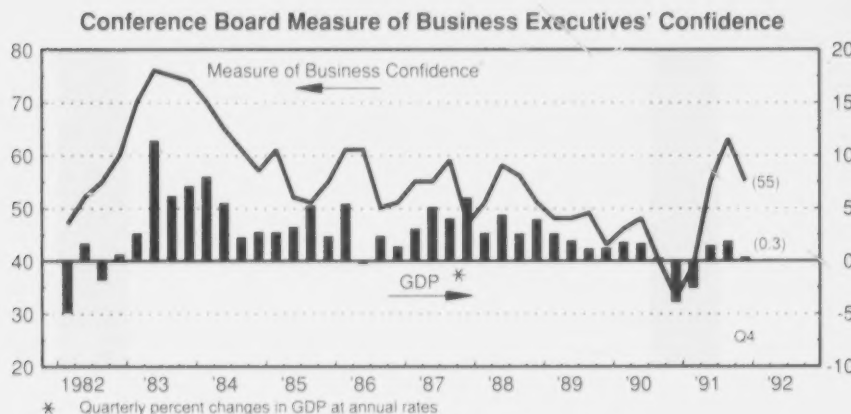
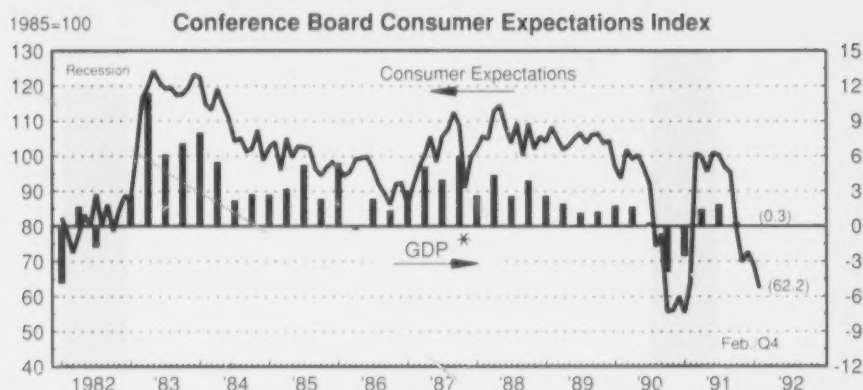
* Core Inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

Confidence

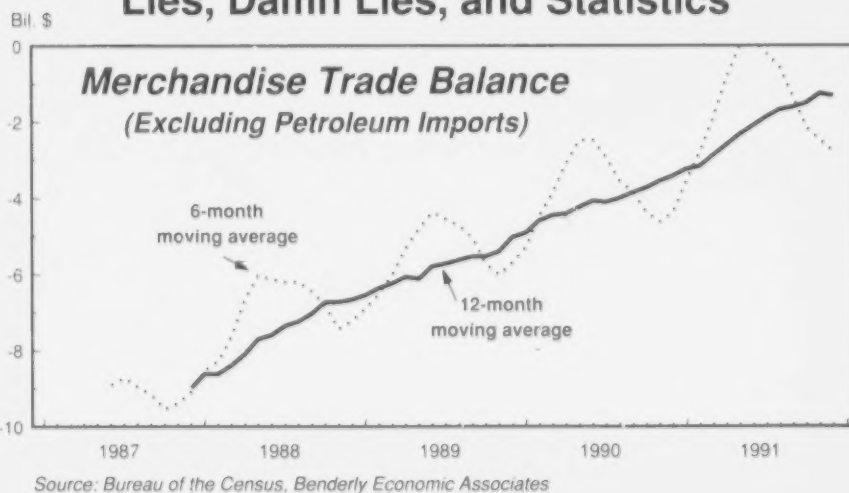


Consumer expectations
weaken further.

Chart of the Month

The media regularly make a big fuss about monthly changes in the merchandise trade deficit. But those changes are so volatile they in fact provide virtually no useful information about our trade performance. Accordingly, to bring out the underlying changes, economists often use six-month moving averages to smooth the data. However, Jason Benderly has uncovered a further statistical problem with this series: As the chart shows, the smoothed seasonally adjusted data are also misleading in that they contain a pronounced seasonal pattern. That's right, a seasonal pattern in the seasonally adjusted series. In the end, then, to gain an accurate perspective on the steady, uninterrupted improvement that's been taking place in our trade performance, we have to eschew the statistical adjustments to the monthly data and revert to the old-fashioned same-month-year-ago changes. In this case, as the bold line on the chart shows, that seems to be the only way to know what's going on.

Lies, Damn Lies, and Statistics



Inside the Crystal Ball

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Date of Forecast	Feb.	Feb.	Feb.	Feb.	Feb.	Feb.	Feb.	Feb.	Feb.	Feb.	Feb.

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	%	
Actual	1991 3Q	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	3Q 1991 Actual
	4Q	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	4Q
Forecast	1992 1Q	-1.0	-1.0	0.5	-0.5	0.3	1.4	2.0	0.4	-0.0	-1.1	-0.0	1Q 1992 Forecast
	2Q	0.4	2.4	2.3	2.0	2.3	1.8	3.5	2.1	2.8	2.8	1.6	2Q
	3Q	2.7	3.4	3.6	3.6	3.3	2.4	3.9	2.9	3.9	3.6	3.9	3Q
	4Q	3.5	3.2	3.6	2.8	2.9	2.3	3.7	2.9	3.7	3.2	4.6	4Q
	1993 1Q	3.6	3.1	3.8	3.5	2.9	1.9	3.3	2.7	3.8	2.9	4.6	1Q 1993
	2Q	3.3	2.7	3.7	2.4	3.0	2.2	2.1	2.6	3.6	3.0	3.8	2Q
	3Q	3.1	2.9	3.5	2.6	2.9	2.7	2.4	2.7	3.1	3.0	3.1	3Q
	4Q	3.0	2.5	3.6	2.1	2.5	2.4	3.9	2.6	2.5	2.8	3.2	4Q
	1994 1Q	2.9					2.2			2.8	2.7		1Q 1994

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Actual	1991 4Q	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	1991 4Q Actual
Forecast	1992 4Q	2.0	3.6	3.4	2.4	3.1	2.8	2.7	2.2	3.4	2.2	2.6	1992 4Q Forecast
	1993 4Q	3.2	3.6	3.6	3.3	3.3	3.3	2.8	2.5	3.1	3.3	2.8	1993 4Q

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual	1991 3Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	3Q 1991 Actual
	4Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	4Q
Forecast	1992 1Q	7.7	7.7	7.5	7.6	7.6	7.5	7.7	7.5	7.6	7.5	7.6	1Q 1992 Forecast
	2Q	7.7	7.6	7.3	7.6	7.3	7.5	8.0	7.3	7.7	7.5	7.5	2Q
	3Q	7.6	7.8	7.2	7.9	7.3	7.5	8.0	7.2	7.8	7.6	7.5	3Q
	4Q	7.7	8.0	7.3	8.0	7.4	7.8	8.0	7.2	7.9	7.8	7.4	4Q
	1993 1Q	7.8	8.0	7.4	8.3	7.5	7.8	7.9	7.2	8.1	8.0	7.6	1Q 1993
	2Q	7.8	8.1	7.4	8.4	7.6	8.1	7.9	7.1	8.1	8.1	7.5	2Q
	3Q	7.9	8.1	7.5	8.4	7.7	8.1	7.9	7.0	8.2	8.2	7.5	3Q
	4Q	8.2	8.2	7.5	8.6	7.8	8.1	7.9	6.9	8.3	8.3	7.5	4Q
	1994 1Q	8.3					8.1			8.2	8.4		1Q 1994

Unemployment Rate

(Percent, quarterly)

Actual	1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	4Q 1991 Actual
Forecast	1992 4Q	7.5	6.8	6.6	7.2	6.8	6.8	6.6	6.8	6.7	7.4	6.9	4Q 1992 Forecast
	1993 4Q	6.8	6.3	6.2	6.9	6.4	6.8	6.3	6.0	6.0	6.9	6.1	4Q 1993
	1994 1Q	6.7					6.8			5.9	6.8		1Q 1994



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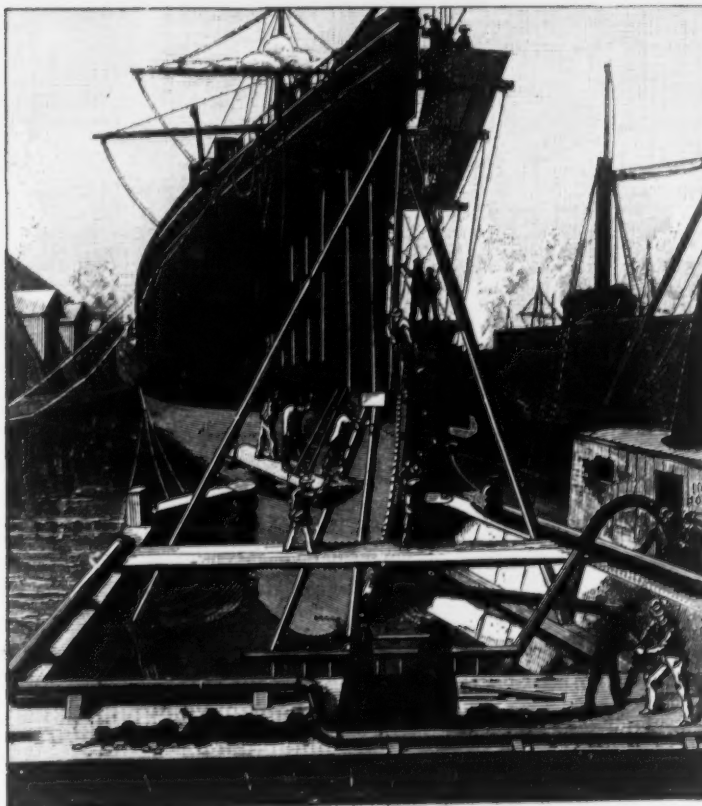
The Conference Board

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Economic Times



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Editor's Note

This being the first month of the quarter, we offer our usual Industry Outlook Report (shaded center section)—a look at economic prospects for seven important industries. Next, drawing on three of his recent *Letters*, our Conference Board compatriot, Al Sommers, reviews the long-term outlook for the U.S. economy from a variety of interesting angles.

Then we hear from another cherished friend of long-standing, Paul McCracken. I love his use of "disestablishmentarianization," the process by which new ideas and new products are tested by the impersonal referee known as the marketplace and then, if successful, compete old ideas and old products out of existence. (And you thought it was only an answer to the trick question, what's the longest word in the dictionary!!)

We also have Owen Harries discussing the tension and hostility that accompanies migration, and our faithful Colloquium panel tackling inflation. And as always, we provide perspective on the U.S. near-term outlook in our Stat File and Crystal Ball. Finally, this being tax month, the maxim below should remind us *not* to complain about paying income taxes.

Ed Fiedler

Maxim of the Month:

The one thing that hurts more than paying an income tax is not having to pay an income tax.

Thomas Robert Dewar, 1864-1930,
British distiller and raconteur

A Close Race?

Among political analysts, it is an article of faith that defeating the re-election bid of a sitting Republican President is, absent recession or scandal, an extremely difficult undertaking. Well, maybe not. The relationship charted below, first examined by professor Edward Tufte, tells us that if real after-tax income per person is rising at better than 2 percent per year, then the candidate from the incumbent party is likely to be elected. Below 2 percent, the "out" party gains the advantage.

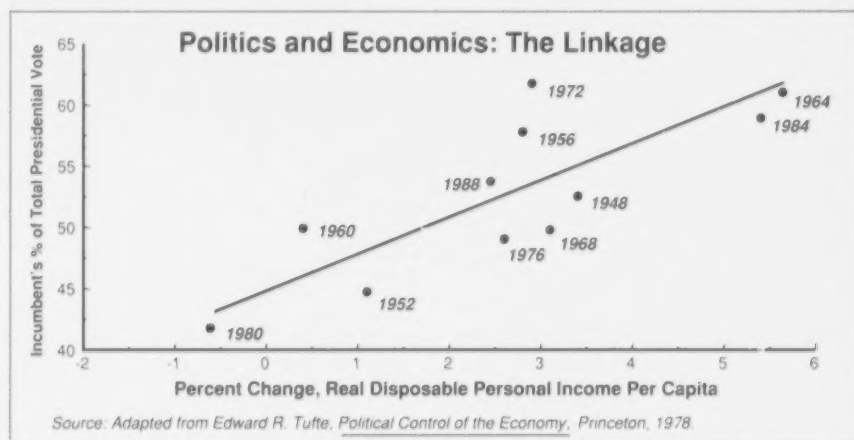
Since Tufte, this simple relationship has further proved itself. The 1980, 1984 and 1988 observations on the chart all fall very close to the diagonal line, confirming the importance of economic performance as a reliable indicator of which way the vote will go.

What does this portend for Mr. Bush's chances in November? The economy is recovering, yes, but perhaps not fast enough to give the in-party candidate an edge. The common forecast calls for real after-tax income per capita to increase between zero and one percent this year. Historically, that's not enough for the Republicans; zero to one percent income

growth corresponds to a 45 to 48 percent vote for President Bush—a clear loss in the popular vote.

The predicted margin is not overwhelming, however, and many things could undermine the forecast. The economy could be stronger than now predicted. On personality or character grounds, one candidate may prove to be much more attractive than the other, as for example Eisenhower proved to be in 1952 and 1956, when he won by substantially larger margins than indicated by income growth. Furthermore, being the incumbent President himself, as Bush is, could be a much greater advantage than simply being the candidate of the party that previously held the office (which is the basis of the relationship used here). For any of these reasons, and others, the election could turn out much different than now signaled by the economic outlook.

For now this year's contest looks like a fairly close race that could go either way. But if, as expected, income growth remains below par in 1992, the election would appear to be an uphill battle for President Bush.



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Colloquium: Inflation Policy

Background

One of the few blessings of recession is the reduction it brings in inflationary pressures. Currently, although not vanquished, inflation is clearly subdued. The advance in consumer prices excluding food and energy (the so-called "underlying" or "core" rate of inflation) has subsided to around 4 percent in early 1992 from about 5 1/2 percent a year earlier. Wage pressures have also eased.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Gail D. Fosler, Vice President and Chief Economist, The Conference Board; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

Question

As the economic policymakers look ahead to the next and presumably more satisfactory stage of the business cycle, what should their goal for inflation be?



Stephen H. Axilrod
Nikko Securities International

Central bankers have a great tradition. Zero inflation's what they are wishin.' But twixt wish and deed, There's economic need, Like growth that's to be saved from perdition.

Think zero if you must.
Two's as good, also just.
Three may squeeze through the door.
Perhaps four, but no more.



Don R. Conlan
The Capital Group, Inc.

Assume no surprises—no oil shock, no big drop in the dollar, no budget-busting, and no money (M2) growth outside the Fed's current target range. Also assume the service sector gets productivity results from its current misery. Cyclical productivity growth should then be strong enough to keep the underlying rate of inflation below 3.5 percent for some time. That's not zero but it's pretty low and should produce lower long-term interest rates. So relax, already! Let's have a little growth!



Andrew F. Brimmer
Brimmer & Company, Inc.

Economic policymakers should not forget about the problem of inflation. After all, a 4 percent rate of inflation cuts the value of financial assets by one-third over a ten-year period. The Federal Reserve should not seek a zero rate of inflation. However, to prevent rekindling inflation expectations (which would push up long-term interest rates and dampen capital outlays), it should restrain the expansion of money to a rate roughly in line with the economy's long-run growth potential.



John T. Dunlop
Harvard University

Economic policymakers do not act in concert on measures affecting inflation rates. There are many goals, and inflation constraint is not uniformly cherished over employment, credit availability, agricultural policy, public projects, or controls on health care costs, particularly in an election year. With little increase in nonfarm business productivity and with wages, salaries and benefits rising in the 4-5 percent range, policymakers are likely to accommodate the resulting inflation rate including the effects of import prices.

The Troubled Trend

by Albert T. Sommers



The feel of the U.S. business cycle at the start of 1992 is different from the usual historical pattern.

This is not just a matter of the feeble recovery from the 1990-91 recession. What is at issue is the strength of the substructure of the U.S. system that controls its longer-term growth potential.

The conclusion reached here is that accumulating changes over the past 10 years have precipitated a general decline in the growth rate of the economy as a whole. The distinguishing feature of the recent recession is not pronounced cyclical weakness; as recessions go, this one was relatively mild. But the trend rate of growth is a different story. It is a striking fact about recent economic performance that U.S. output falls below virtually any trend value constructed from U.S. experience since 1960. If real output were to increase 1 percent in 1992 and 3 percent in 1993, a projection not far from the current consensus, the four-year growth rate for 1989-1993 would be a dramatically low 1.1 percent.

The Labor Force and Productivity

Arithmetically, growth is a product of the number of people at work and the output achieved per person. The civilian labor force, as the accompanying chart shows, has been falling, relative to trend, for many years. In 1991, the actual labor force fell almost six million workers short of the 1970-1990 trend.

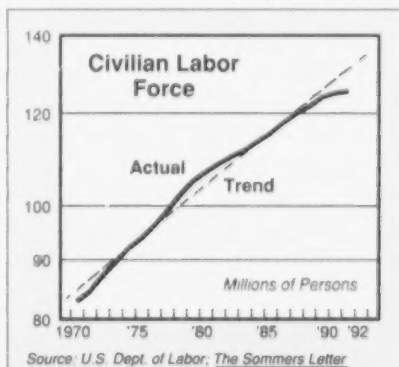
More important than the crude supply of labor is its quality, training and skills.

The United States is disadvantaged, in the sense that its average literacy and educational levels are deficient relative to its major international competitors. Thus new labor-force entrants are poorly equipped for the increasingly technical jobs that are replacing low-level clerical and physical jobs—an obvious threat to productivity performance.

With respect to productivity, the statistics again suggest caution beyond the issue of a skills mismatch. The U.S. structure remains heavily consumption-oriented; its saving and investment ratios are significantly lower than those of its international competitors. Pessimism on this subject can perhaps go too far; in manufacturing, the productivity gain in the United States in 1989-91 was generally good. But the inclusion of service industries in the aggregate productivity measure produces deplorable total performance—a trend rate of 1.1 percent since 1984, and zero net change since 1988. The saving and investment expansions required to elevate this performance are not by any means discernible yet (see chart, p. 5).

A Laboring Government

With respect to its bearing on the growth potential the government sector has temporarily exhausted its capacity to provide energy to the private sector. The cuts in the defense, unequivocally beneficial long run, are bound to produce dislocations and adjustments throughout the defense sector for many years ahead.



The opportunities to convert this decline in outlay into a stimulative decline in taxes are obstructed by the size of the aggregate deficit, and by the continuing uptrend in transfer-type outlay. This circumstance applies with equal force to state and local governments, whose aggregate employment is five times that of the Federal government, and which we should expect to be in a period of consolidation for the next half decade. Thus the constraints on government seem to impose a limitation on the growth prospects of the system as a whole.

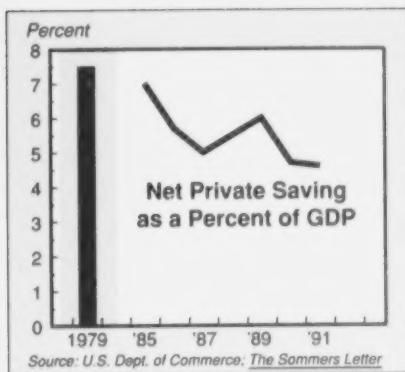
The Political Impasse

In the presence of prolonged sluggish growth, the social issues to which government addresses itself have congealed into a tough, hard-shelled mass. One such issue is the prolonged slow growth in most incomes, which has generated a broad definition of a middle class that has been disadvantaged and merits favorable tax consideration; while below that class in the income distribution is now an "underclass" still more urgently in need of governmental assistance.

More important issues are the still inchoate state of the debate on health insurance and the continuing negative information on the quality of education. But the tendency of voters to place very high priorities on such programs, as well as on drugs and crime, is not now matched by their willingness to finance increased participation of government efforts in these areas, and the political leadership (as well as the money) required to face up to the costs realistically is lacking thus far in 1992. The weakened political posture of government, moreover, disposes it toward politically inspired concessions that are not in the interest of long-run growth.

Private-Sector Considerations

On the demand side of the system, U.S. prospects also carry inhibitions.



Throughout the 1990s, domestic demand will be contained in some degree by demographics—a very low household formation rate affecting the underlying vigor of housing and consumer durables. These demands and others are also affected by the abnormal levels of private debt generated in the 1980s. Excesses in the commercial construction market will weigh heavily on that sector for several more years; and the overhang of housing inventory held by the RTC militates against strong gains in residential construction. Finally, real interest rates in the United States remain abnormally high, which is also a substantial consideration with respect to both housing and inventory demand.

These observations on the condition of consumption spending in the 1990s are certainly inconclusive. But in conjunction with other troubles of the long-term trend described here, they carry mild and uncertain corroboration of the conclusion that growth in demand in much of the 1990s will not approach the rate achieved in much of the 1980s.

The Social Burden

In the 1990s the U.S. economy is living with a rising burden of "social costs," much more pronounced in the United States than among other developed nations. This burden continues to grow and spread. Public spending for "social welfare" now totals about \$1 trillion, and is rising at \$50 billion a year. This includes all social insurance, public aid, health and medical programs, veterans' programs, educational outlay, and housing outlay. Other costs confront-

ing the system include an "underclass"—an under-educated, unproductive, ill-housed, dependent, largely untaxed population, prone to drug and alcohol addiction and crime—that is difficult to describe, difficult to measure, difficult to treat, but which surely stands in the way of vigorous economic growth.

These issues, taken together, pose a great American dilemma. Failure to treat them will perpetuate them as a limit to growth. But aggressive treatment of them would cost a vast multiple of what the American political process now seems at all likely to deliver.

The Ethical Burden

The ethical issue here is not the American "work ethic" so assaulted by Japanese politicians and businessmen. The U.S. work ethic among those integrated into the ongoing work force seems entirely reputable and appropriate. The issue here is the "public ethic"—the widely accepted ethical practices and standards that preserve social order, and support respect for public authority and the rule of law itself. An ethical system in deterioration carries heavy costs for the productive part of the system, in elevated security requirements, environmental costs, tax evasion, growth of the underground economy, and the costs of crime ranging from pilferage to financial and public fraud.

The weakened political posture of government disposes it toward politically inspired concessions that are not in the interest of long-run growth.

The erosion of family structures multiplies educational costs, crime costs, drug costs. The intense search for individual protection against risk, regardless of the social costs, drives environmental and product-liability regulation to extremes. Relaxations of a public ethic

compromise support for public programs that deal with equal opportunity, education, early family environment.

These conditions are, of course, always present in some degree, human beings being human, but they appear to be far more than normally present in the early 1990s, after a decade during which public responsibilities were so subordinated to the search for personal success in private markets. Of all the reasons for expecting slow real growth for several years ahead, these concerns, whose connection to economic growth itself defies the methods of economics, may turn out to be among the most important of all.

Conclusions

All of these issues can be condensed into three major descriptions of the drain on long-term growth. First, the system is emerging from, but continues to be dominated by, a hangover of the "bubble-economy" of the 1980s.

Second, the consumption orientation of the U.S. system continues to dictate inappropriate decisions with respect to taxes; for example, proposed reductions in personal taxes, the failure to increase oil taxes, the failure to legislate value-added taxes, and failure to finance a considerably higher level of public and private investment, when the need is clearly accumulating.

Finally, the social and ethical issues described here, and their effects on the political process, are deep-seated and long-term. The costs of a deteriorated public ethic are impossible to measure, but very high with respect both to our own past record and to the current records of our competitors. As the world's largest multi-racial, multi-ethnic, multi-class society, the United States requires a degree of leadership as great as any nation in the world; it will take very high leadership indeed to rebuild a public ethic consistent with rapid and sustained long-term economic growth.

Albert T. Sommers is Senior Fellow and Economic Counsellor at The Conference Board.

Disestablishmentarianization and Democracy

by Paul W. McCracken



For a system to generate progress there must be freedom for unlikely ideas from unlikely locations to have a go at it.

A giant question mark hanging over the world economy is whether the erstwhile government-managed economies of eastern Europe and the former U.S.S.R. can successfully metamorphose into liberal, market-organized systems. We are clearly seeing here a convulsive effort in history of nothing less than Homeric proportions. On its success depend the hopes of those people for a sustained and widely diffused rise in their material levels of living.

Moreover, it is clear from international experience that political democracy and a state-managed economy are incompatible. No country has both. The yearnings of these people for democracy can only come to fruition if they can make it to a liberal, market-organized economic order. (This statement is not, of course, reversible. A market-organized economic system does not assure democracy, but it is a necessary condition.)

We now understand why the liberal economic order turns in a better performance. First, it can make use of an aggregate of knowledge and creativity not found in its totality anyplace. New ideas for something new and better usually emerge from the most unlikely places. The modern calculator did not emerge from those who made slide rules. Wagon and carriage manufacturers did not bring us automobiles. For a system to generate progress there must be freedom for unlikely ideas from unlikely locations to have a go at it.

Second, the new must be tested out by the impersonal refereeing of the marketplace. If the new is better, it competes the old out of existence—this no matter the frowns of manufacturers or bureaucracies who have grown comfortable with the old. The liberal economy has a process for continuing and systematic disestablishmentarianization, and the process is central to progress.

Third, an economy delivering vigorous progress is not a secure place. Old, tried-and-true skills and professions and businesses are in danger of finding themselves out of the ball game, replaced by the new and better that came from an unexpected direction. This does not mean that the rapidly progressing liberal economy has large unemployment. Productive resources get shifted to new and better uses. The unemployment rate for the first three decades of this century, a good period for the U.S. economy, averaged 4.7 percent, and for the quarter of a century from 1948 to 1973 the rate was 4.8 percent. Indeed, it is the dynamic economy with strong rates of economic progress that is apt to have low unemployment rates, and it is the slow-moving, sclerotic economies that tend to have the most troublesome unemployment problems.

Questions About the Transition

This all poses three central and interacting questions about the ability of the eastern European and former U.S.S.R. economies to make the transition. Will the governments, including importantly the bureaucracies, be willing to accept the reduced role that is essential if a market economy is to work? This disinclination may range from not finding it credible that something will happen unless there is a diktat from some government bureau, to simple unwillingness to give up prerogatives and power.

Second, and this may be the most difficult problem of all, will the citizenry in those countries accept the trauma and messiness that will be involved during a transition that may extend over a period of several years? Out of sheer exasperation and desperation, and with encouragement from an officialdom and bureaucracy whose status is reduced in a liberal economic order, there could be a convulsive 180 degree turn about to the old system. Moreover, the

(Continued on p. 7)

The Conference Board

Industry Outlook Report

Overview: Unexciting Upswing



Edgar R. Fiedler
The Conference Board

This latest round of reports from our distinguished panel of industry specialists shows a solid pattern of moderate growth prospects across all seven industries. Only one of our analysts—for general merchandising—is still unconvinced that a cyclical recovery is underway. And even he, joined by our other more cautious contributor, for motor vehicles, expect a slow recovery for their industries in 1992.

Three other analysts emphasize the company-by-company diversity of prospects. In banking the key is location: In many cases even a vigorous national recovery will not offset losses from regional credit problems. In chemicals, the key is the firm's product portfolio. Profits of bulk-petrochemical producers are hurting because their selling prices are under pressure, whereas the "value-added" producers benefit from low input costs. Among the airlines the key is having enough domestic hubs tied to comprehensive international routes. The carriers that survive, we hear, "will show the best airline performance ever," because "the profit-killing wars are nearly over."

The two industries in this report with the most favorable outlook are business services and capital equipment. Neither analyst is highly optimistic but both expect solid gains in output in 1992 and 1993. Our specialist in business services

calls for growth there to outpace the other service sectors. Even stronger, capital goods are expected over the next five years to "show the best growth of any major sector of the U.S. economy."

One factor supporting capital equipment—in both the recession and the continuing recovery—is exports. The same point was made for the chemical industry, except with more caution about the year ahead. On the other hand, this time around none of our panel expressed any worries about inflation.

In summary, if reality follows our forecasts, it all adds up to nothing fancy, nothing exciting, just a steady recovery at a moderate pace. But is there anything wrong with that? If our social safety net had fewer holes in it, not much at all. Always welcome.

Capital Equipment: Solid Gains Ahead



Adrian T. Dillon
Eaton Corporation

Capital equipment is in the initial stages of recovery from recession. Last year, U.S. equipment purchases fell 3½ percent (real), about one-third the average decline in previous recessions. Information processing equipment was—despite the headlines about restructuring at IBM and other high tech companies—the major source of strength. The "problem" for this industry is that, with prices falling 5 to 10 percent per annum (15 percent for computers alone), a 7 percent increase in "real" purchases—a boom elsewhere—translates into flat or declining revenues and imploding profits. The industrial equipment sector took it on the

chin, falling 6 percent in 1990 and an additional 12 percent in 1991.

With real GDP rising modestly this year and a bit more respectably in 1993, capital equipment should play its traditional accelerator role. Information processing will be supported by deliveries of a new generation of IBM mainframes and by the continuing revolution in computing technology. Industrial equipment follows capacity utilization very closely, and thus should rise just a little this year and more strongly in 1993. (See table for details.)

Capital Equip. Purchases (pct chg)

	1991p	1992p	1993e
GDP	-0.7	2	3.5
Cap. equip.	-3.5	8	8.5
Info. proc.	7	11	10
Aircraft	10	10	0
Ind'l equip.	-12	2	8
Autos (mil.)	12.3	13.5	14.3

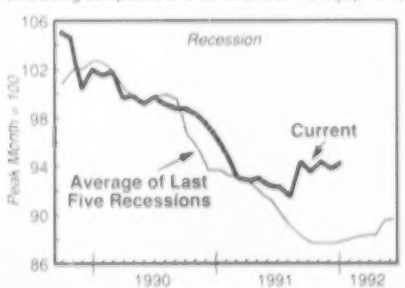
These numbers probably look surprisingly favorable, but it's likely that *shipments* of capital equipment will do even better than purchases. As the chart shows, shipments of industrial equipment fell less than usual during the recession and have been rising since last August. The

reason is foreign trade. Total capital goods exports rose 10 percent last year, despite recessionary conditions in much of West Europe and a slowdown in Japan. Thus, while U.S. *purchases* of equipment fell 3½ percent last year, U.S. *shipments* of capital goods dropped only 1.6 percent.

A gradual recovery in the U.S. and Europe, sustained strength in East Europe and Asia, and building momentum in Mexico and Latin America suggest that total U.S. shipments will rise over 9 percent this year and again in 1992. Over the next five years, capital goods should show the best growth of any major sector of the U.S. economy.

Machinery Orders

(excluding computers and communications equipment)



Business Services: Up But No Major Takeoff



Joseph W. Duncan
Dun & Bradstreet

Employment statistics are probably the best single statistic to examine what's happening in business services. Expenditures for business services are neither consumption nor investment. More traditional sources of information such as the National Income Accounts, production, productivity or foreign trade statistics simply do not explicitly recognize business services as a component.

Business services include such diverse areas as credit reporting, advertising, and data processing. Unlike many other sectors of the economy, most business service functions can either be performed "in-house" or by other firms. This has contributed a great deal of volatility to the sector.

Employment in the service sector has grown faster than overall employment in each year since 1966. Since then, growth in business services employment exceeded service sector employment growth in each year except 1971, 1975, 1982, and 1991, all recession years. Following each of these years, business services employment bounced back sharply. During the 1980s, business services employment growth averaged a whopping 7.6 percent annually, versus a still-healthy 4.7 percent for the entire service sector.

Thus, business services are highly sensitive to the business cycle, but on a higher plane of growth. When a recession

hits, firms first attempt to perform an increasing number of business service functions on their own, reducing their expenditures on other firms' services. For example, an accountant may wear the hat of a credit manager. However, the need for business services always remains. Toward the end of a downturn, businesses resume their purchases of these products when more resources are available.

This is what we are seeing currently. In 1991, business services employment grew 1.2 percent. Within this sector, credit reporting firms added 4.9 percent to their payrolls, advertising employment fell 2.5 percent, but computer services staffing levels increased 6.4 percent. At the end of last year, the trend was up in most areas. A major takeoff of business services employment is probably not in the cards for 1992, but growth in this area will definitely outpace growth in other service areas and the economy as a whole.

Chemical Industry: Reasonably Healthy Growth



A. Nicholas Filippello
Monsanto Company

The U.S. chemical industry's fortunes this year will be closely tied to the health of the U.S. and world economies, and particularly to key end-use markets. The most important of these are automotive vehicles, construction, agriculture, packaging and consumer purchases of carpeting, appliances, home furnishings, apparel, cosmetics, soaps and detergents, pharmaceuticals and food.

Based on the consensus view of a slow upturn in the English-speaking economies, a weakening in Germany and Japan, and a general convergence to growth averaging some 2-2½ percent over the next year, the chemical industry can be expected to experience reasonably healthy annual volume growth over 1992-93 of 3-4 percent. Latest signals in the United States suggest the long-awaited upturn may be at hand.

Because it is international, the chemical industry is critically affected by worldwide economic trends and oil and gas prices. The U.S. industry has developed a strong international trade surplus, even as production in basic petrochemical capacity has grown around the world. The principle international strength has been in the high value-added and high technology end of the market, including pharmaceuticals, high performance materials and specialty products. This reliance on international markets has been a source of

strength during the recent U.S. recession. However, it could also limit the recovery over the coming year as economic growth outside the U.S. slows.

Company prospects differ depending on the product portfolio of a given firm. Producers of bulk petrochemicals will benefit less from economic recovery than "value-added" producers. This is because petrochemical capacity is increasing and hydrocarbon prices are weak, which means commodity producers are realizing relatively low prices while value-added producers benefit from low input costs.

The industry is going through another round of restructuring and downsizing. This will lead to cost reductions and productivity enhancements that will significantly increase profit margins once capacity utilization rates rise back into the low-to-mid 80 percent range. Profit growth will be moderated, however, by the costs of environmental compliance.

Auto Industry: Slow Recovery



Donald P. Hilty
Chrysler Corporation

Since the beginning of 1990, U.S. car and truck sales have tracked below trend. Sales shortfalls early last year were as severe as during the 1982 recession. In the past 12 months, sales have zigzagged around an annual rate of 12.5 million units—a pace lower than expected in an “average” recession. The auto industry can build 6.9 million more cars and trucks in North America than it can sell; that is one-half million *more* unused capacity than in 1982.

But the stage is being set for a recovery. Auto installment debt declined last year, the first time since 1958, by over \$13 billion. Less profitable sales to daily

rental companies have been cut back and are approaching the normal two-a-year pattern. Inventories are back to normal seasonal patterns in terms of days supply. And showroom traffic is running 5 percent better than a year ago, while the sales closure rate is up 4 percent. Sustained improvement in the sales pace would quickly trigger increased production.

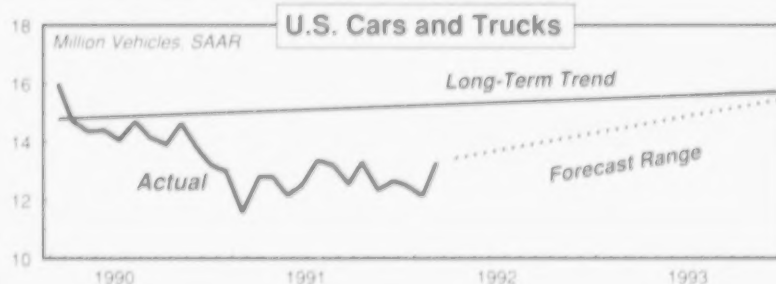
However, most auto analysts, reflecting the consensus forecast of only modest overall economic growth, expect this auto industry recovery to be the slowest since World War II. Car and truck sales should total around 13.5 million units this year and perhaps 15 million next year. At these rates, sales would not approach trend until the end of 1993. The

U.S. Car & Truck Industry Percent Change

	Unit Sales	Profits
	year-to-year percent change	
1990	-4.7	-88
1991	-11.4	Record Losses
1992e	8.0	Breakeven
1993e	11.0	Respectable Profits

domestic industry has cut costs dramatically, and continues to do so, in order to break even this year and return to respectable profitability next year.

Thus the auto industry is basing its operations on a very slow recovery. We may be pleasantly surprised, however, because industry sales have increased 15-20 percent in the first year of the past five auto recoveries, regardless of GDP advance.



Financial Institutions: Major Challenges



Karen N. Horn
Bank One, Cleveland

Financial institutions underwent major changes in the 1980s and face more major challenges in the future. Domestic banks have been losing market share to both nonbank competitors and foreign banks. From 1975 through 1990, U.S. bank's share of commercial and industrial loans fell from nearly 71 percent to under 50 percent. More dramatic is the decline in bank's share of short-term

credit to large corporations. This share fell from 50 percent in 1975 to around half that by the end of the 1980s. Bank's share of consumer loans has fallen as well, as nonbank competitors have successfully made inroads into this market.

Increased competition from unregulated competitors combined with outdated regulation has increased the vulnerability of banks to changes in economic conditions. Branching restrictions have effectively limited geographic diversification, creating a greater vulnerability of banks to regional economic conditions. The large number of insolvent thrifts that operated throughout the 1980s had a corrosive effect on net interest margins for both banks and thrifts and contributed to a speculative run-up in real estate prices in a number of regions. Banks themselves misstepped as they overbooked real estate, energy, and LBO credits. The result

has been a sharp increase in nonperforming loans and increasing bank failures.

The Outlook. Banks face a number of challenges over the next several years. Near term, the banking industry must both downsize and recapitalize. An important element of the restructuring is comprehensive legislative reform of banking regulation. The industry has had some recent success in issuing new equity in capital markets, but it is not clear this trend will continue without fundamental changes in bank powers that will enable banks to earn high enough returns to attract new equity. Signs that the national economy may be in the early stages of a recovery are positive for banks in general. In many regions, however, banks still face an uncertain and difficult future because the national economic recovery will do little to alleviate the regionally-related credit problems in their portfolios.

General Merchandise Retailing: Despite Gloom, Gradual Recovery



Walter F. Loeb
Loeb Associates Inc.

January and February were great months for many retailers. Sales increased substantially, and profits were up even more. The reasons are simple. First, last year an apathetic consumer focused on the war in Kuwait and spent little, so this year comparisons were easy. Second, retailers over the past two years have tightened their staffing drastically in or-

der to lower costs. Thus, current sales increases are being translated into profits. These traditional optimists are not yet, however, loosening their purse strings for either staffing or inventory. They are still not convinced that an economic recovery is in place.

Neither am I!

The consumer remains very cautious. She shops late, when she needs something, not when she simply wants the item. Shopping for an event or a holiday is done at the last moment. The demand for value also remains: the consumer wants to buy on sale, at a discount or wholesale, whatever it takes to stretch the family budget. Discount stores should continue to benefit from this attitude.

Consumers are worried. First of all, they worry about employment; too many friends are out of work. The unemployment rate will probably remain around 7 percent throughout 1992. Consumers are

also concerned about their own careers. With cutbacks in the industrial sector, there are fewer promotions, fewer bonuses, even fewer salary increases. Consumers also continue to worry about high taxes and health care costs.

In spite of this generally gloomy view, the action of the stock market has encouraged the more upscale consumers. Thus, specialty store and department store sales should gradually improve in 1992.

I look for a slow recovery in the economy through most of 1992. For the full year, I estimate real GDP will increase 2.8 percent with inflation rising 3.5 percent. For general merchandise, I project a 2.3 percent gain in real terms, 5.7 percent in nominal terms. Much of this gradual recovery should come in the second half of 1992. If housing starts continue to accelerate and if capital spending also has some bounce, my estimates may need to become more optimistic.

Airline Industry: Bright Outlook for Large Carriers



George James
Airline Consultant

Three major carriers died last year (Pan Am, Eastern and Midway). Three have double pneumonia with temperatures over 105 degrees (TWA, Continental, and America West). Two have the walking flu (US Air and Northwest). The remaining three largest airlines (United, American, and Delta) have head colds that will soon go away. Two others, Southwest and Alaska, have remained relatively healthy because they took preventive medicine and stayed away from

the climate of the others, a condition likely to continue.

All of these illnesses came about because of the Gulf war, sharp fuel price increases, the U.S. recession, and heavy price cutting by the weakened airlines. Taken together these adversities brought about nearly \$5 billion in net losses in 1990 and 1991, more than airline total net profits since World War II.

The results: Over a thousand planes have been grounded, tens of thousands of employees are out of work, \$10 billion of aircraft orders and options have been canceled, and investment sources for equipment financing have essentially vanished.

In the future, only the large airlines—whose with numerous domestic hubs tied to comprehensive international routes—will be significant carriers. American, United and Delta are in this group. Among the rest, one or two amalgamations might be formed by taking the best of each and shedding all else, including high labor costs and restrictive work rules.

Financially, the worst is over. In 1992 the industry can be expected to make a small profit—less than one percent operating margin or about \$500 million on nearly \$80 billion of operating revenue. Then, as fares rise more in line with inflation—something not possible in the past when many airlines often priced below costs—the remaining carriers will show the best airline financial performance ever. Recent proposals to raise discount fares by 2 percent are indicative of this trend.

The U.S. airlines are famous for volatile profit performances but this time they will rise to new heights and, surprisingly, stay at those profitable levels for the indefinite future. The profit-killing wars are nearly over.

U.S. Airline Industry Operating Results

	1990	1991p	1992e
Revenues (\$ bil)	76	74	78
Profits (\$ bil)	-2.0	-2.0	0.5
Profit Margin (%)	-2.5	-2.7	0.6

key prime-mover in a liberal economy is the entrepreneur. If the entrepreneurs are doing their job, they will be the affluent citizens of their nation, and it may look as if decades of propaganda—that these “capitalists” get rich by appropriating what belongs to ordinary people—is correct.

Most difficult of all, will the citizenry in eastern Europe and the former U.S.S.R. accept the trauma and messiness that will be involved during a transition.

The final question is whether the people will accept the greater and more ma-

ture responsibility for their own destiny that is inherent in a liberal, market-organized economic order. The liberal economy will deliver more rapid progress, but the fortunes of any individual or profession or business are inevitably more insecure. And unease about such insecurity will be compounded by the inevitable disarray of the transition.

No Alternative

We can, I believe, have confidence that the forces pushing in the direction of international economic disintegration will be countered, and that a liberal political and economic order will be the underpinning of the world community in the decade and, indeed, the century ahead. The consequences of setting out on an alternative path are simply too obvious and too appalling. Zbigniew Brzezinski put it well in his recent book:

Humanity's catastrophic encounter with communism during the twentieth century has thus provided a painful but critically important lesson: Utopian social engineering is fundamentally in conflict with the complexity of the human condition, and social creativity blossoms best when political power is restrained. That basic lesson makes it all the more likely that democracy—and not communism—will dominate the twenty-first century.

And democracy requires as a necessary condition a liberal economic order.

Excerpted from a lecture to the International Industrial Development Foundation, New York City, October 21, 1991. Paul W. McCracken is University Professor Emeritus at the University of Michigan, and former Chairman of the President's Council of Economic Advisers.

Quotable Quote

By Owen Harries



Migration is a looming issue. Large-scale, sustained, and uncontrolled migration from third world countries to the developed industrialized ones, with all the tension and hostility that would entail, is a real prospect.

Unless third world countries make remarkable economic progress, or unless the developed countries can seal their doors very effectively, and both things are very improbable, millions will migrate—driven by misery at home and drawn by the good life that television, and the increasing number of friends and relatives who have gone ahead, will tell them about.

When this happens it can be expected that America, with its tradition of accepting immigrants, will cope reasonably well. Indeed, it is already coping well—for the United States already took in more immigrants in the 1980s than in any previous decade in its history, and 90 percent of them were from third world countries.

On the other hand, a Japan that sets great store by racial purity will continue to exclude immigrants virtually completely, and will solve its labor problems by moving factories to the third world, rather than letting immigrants come to Japan.

As Graham Fuller observes, the region that will be hit hardest by the influx will be Europe, traditionally and until very recently a huge exporter of people, not an importer, and a continent of comparatively homogeneous nationalities. Europe will neither be able to keep immigrants out nor to cope with them when they are in place.

The strains are already clearly evident as a result of the relatively modest numbers—10 million or so—who have already arrived there. Most of these are Muslim and they are not being absorbed into the general population. As the French historian Jean Marie Domenach puts it, “Even as we are integrating all Europe, we can see a Muslim community that cuts across European lines, a sort of thirteenth nation of the European Community.” That thirteenth nation will grow rapidly, both because of high birth rates and further heavy immigration. Indications of the politically explosive character of this process are already being given by those leading French politicians from both Left and Right who have decided there are votes in exploiting racial resentment and hatred. And in Germany, the first anniversary of unification in September of this year was marked by widespread riots directed against migrant hostels. The problems will be all the worse, and will be made more complex, because of the virtual certainty that mass South-North immigration will be combined with mass East-West flows.

Excerpted with permission. “The Third World, R.I.P.,” ©The National Interest, No. 26, Winter 1991/92, Washington, D.C. Owen Harries is editor of The National Interest.

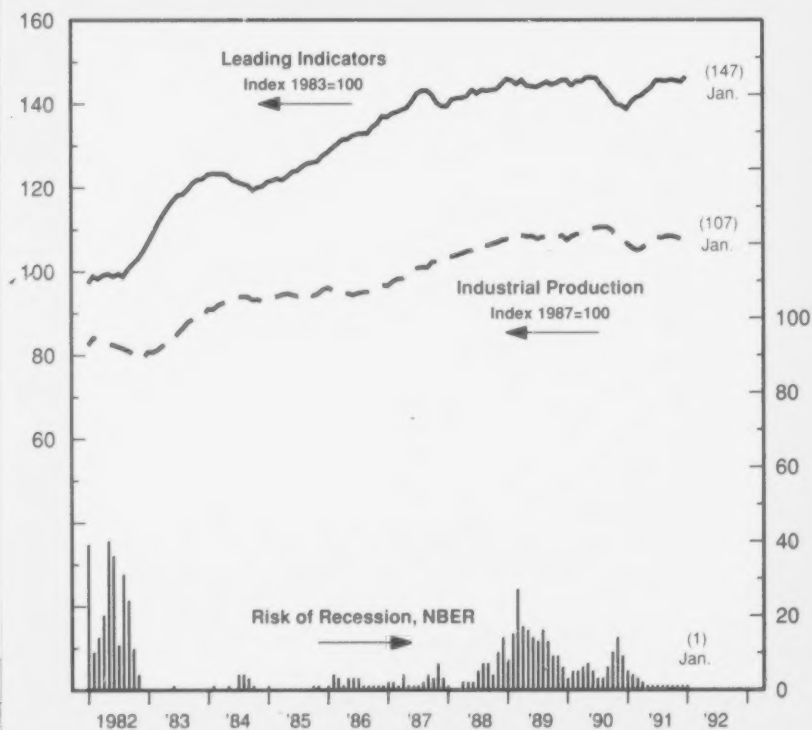
Conference Board Stat File

Slow Recovery Back On Track

The economic signs and portents are full of inconsistencies and contradictions. The leading indicators (this page) are up nicely at latest reading, supported by the purchasing agents' survey. Yet consumer confidence (page 10), despite a slight improvement in the latest numbers, continues to cast a black cloud over the outlook. On the other hand, favorable expectations dominate the mood of CEOs (page 10), CFOs and business economists. And retail sales rebounded briskly in January and February. But business cycle news from abroad is mostly sour. Also, the U.S. labor market data (this page) remain deeply discouraging. Inflation (page 9), however, is encouraging. On balance, where all this nets out is that the uncertainty about the U.S. business cycle has been resolved, with the much ballyhooed "double dip" recession coming close to reality but proving at the last minute to be an illusion. Consequently, the gradual cyclical recovery that got underway last spring seems to be back on track. But the key word is *gradual*. (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

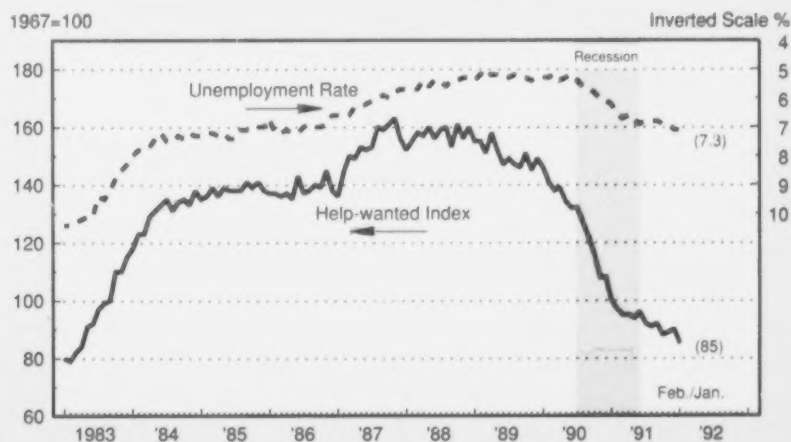
Early Warning Indicators

*Leading indicators
revive a bit.*



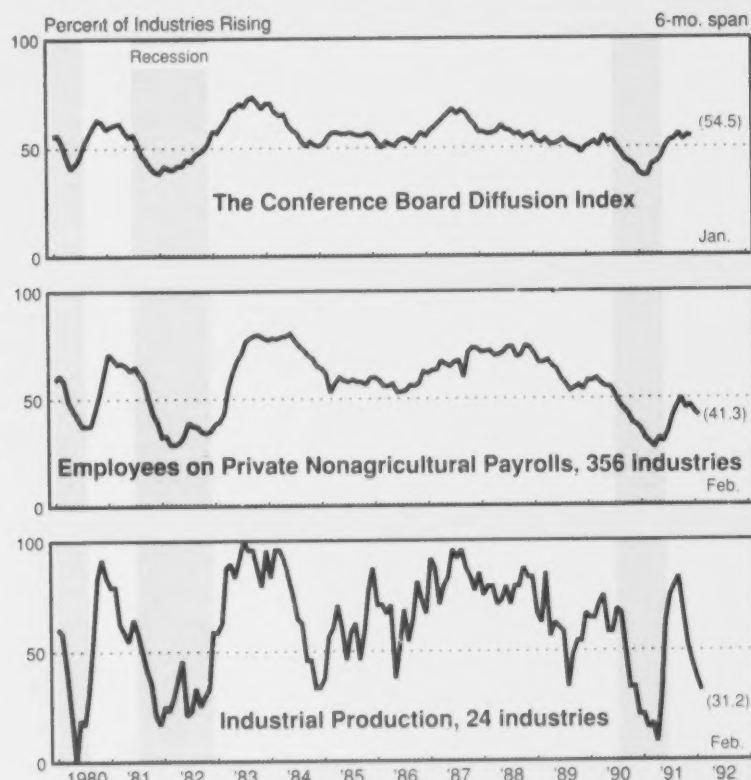
Help-Wanted Advertising and Unemployment

*Labor market
weakness continues.*



Conference Board Stat File

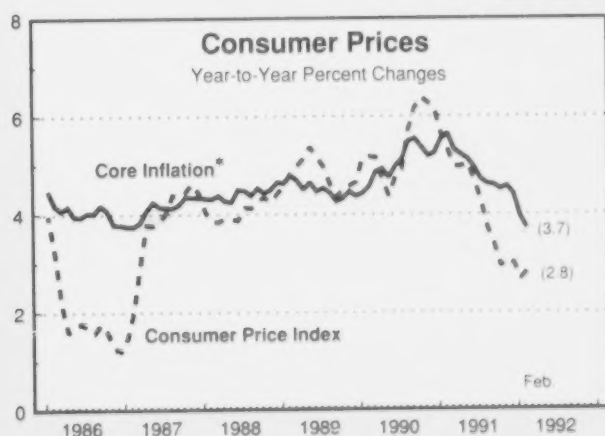
Indexes of Economic Momentum



Slowdown persists.

Inflation slower but not vanquished.

Inflation Fundamentals



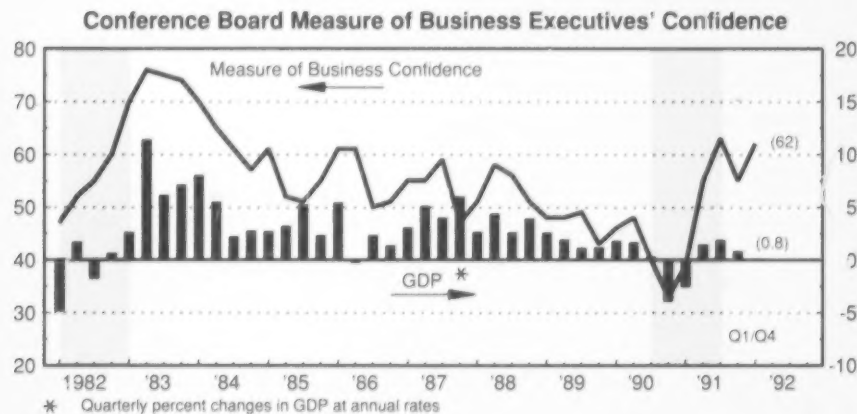
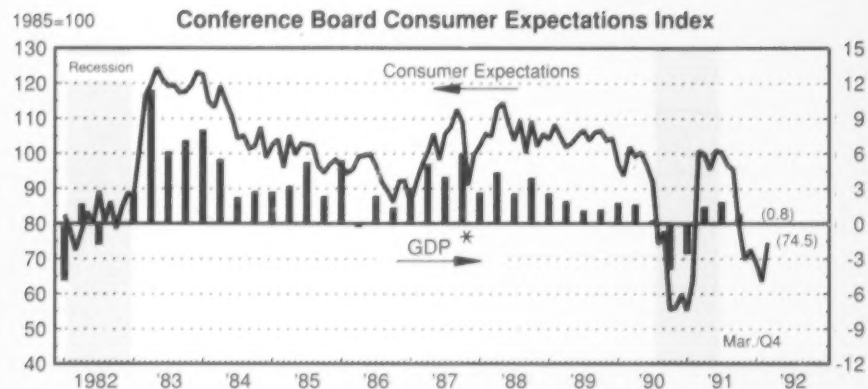
* Core Inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

Confidence

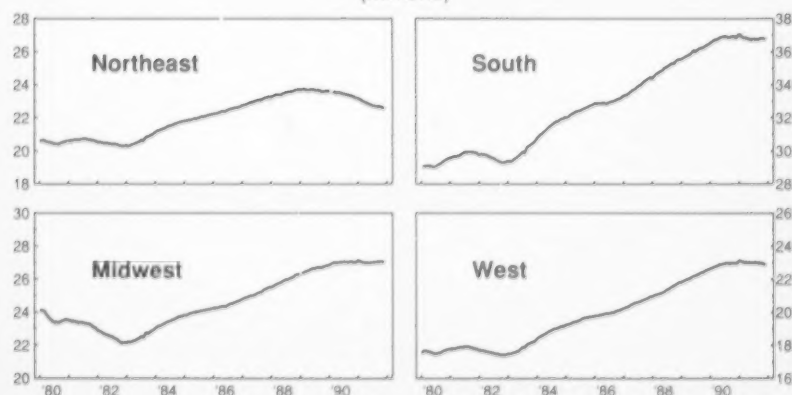


Remarkable dicotomy persists between consumers and executives.

Chart of the Month

The regional disparity in this recession has been severe, with the Northeast area taking by far the biggest hit. Indeed, the Northeast accounts for almost 80 percent of the decline in total non-farm payrolls since July 1990.

Payroll Employment (millions)



Source: BLS and C.J. Lawrence Weekly Economic Briefing, March 16, 1992

Inside the Crystal Ball

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Date of Forecast Mar. Mar. Mar. Mar. Mar. Mar. Mar. Mar. Mar. Mar. Mar. Mar.

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	%		
Actual	1991 3Q	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	3Q 1991	Actual
	4Q	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	4Q	
Forecast	1992 1Q	-1.1	0.3	-0.0	0.7	0.3	0.9	1.1	0.0	0.3	-0.9	-0.3	1Q 1992	Forecast
	2Q	1.7	2.4	2.3	2.5	2.3	1.8	2.6	2.4	2.9	2.1	2.3	2Q	
	3Q	2.7	3.4	3.6	4.3	3.3	2.6	3.9	3.1	3.3	3.8	4.2	3Q	
	4Q	2.4	3.2	3.6	3.7	2.9	2.3	3.7	3.2	3.6	3.2	4.8	4Q	
	1993 1Q	3.1	3.1	3.8	2.6	2.9	1.8	3.2	2.8	3.3	3.0	4.7	1Q 1993	
	2Q	3.0	2.7	3.7	3.1	3.0	2.3	2.1	2.7	3.6	3.1	3.8	2Q	
	3Q	3.0	2.9	3.5	2.4	2.9	2.8	2.4	2.8	2.8	3.0	3.4	3Q	
	4Q	2.9	2.8	3.6	1.7	2.5	2.5	3.9	2.6	2.6	3.1	3.3	4Q	
	1994 1Q	2.7					2.2			2.8	3.2		1Q 1994	

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Actual	1991 4Q	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	1991 4Q	Actual
Forecast	1992 4Q	2.1	3.3	3.4	2.7	3.0	2.7	2.7	2.2	2.9	2.5	2.6	1992 4Q	Forecast
	1993 4Q	3.3	3.6	3.6	3.7	3.2	3.2	2.8	2.6	3.0	3.3	2.9	1993 4Q	

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual	1991 3Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	3Q 1991	Actual
	4Q	7.9	7.9	7.9	7.9	7.9	7.8	7.9	7.9	7.9	7.9	7.9	4Q	
Forecast	1992 1Q	7.8	7.8	7.8	7.8	7.8	7.7	7.8	7.7	7.8	7.8	7.7	1Q 1992	Forecast
	2Q	7.7	7.9	7.7	8.0	7.6	7.8	8.0	7.6	8.1	7.7	7.6	2Q	
	3Q	7.6	8.0	7.5	8.1	7.4	7.8	8.0	7.3	8.0	7.7	7.5	3Q	
	4Q	7.7	8.2	7.5	8.3	7.5	7.8	8.0	7.2	7.9	7.9	7.5	4Q	
	1993 1Q	7.7	8.2	7.5	8.5	7.6	7.8	7.9	7.1	8.3	8.1	7.8	1Q 1993	
	2Q	7.8	8.3	7.5	8.6	7.7	8.1	7.9	7.0	8.4	8.2	7.7	2Q	
	3Q	8.0	8.3	7.5	8.9	7.8	8.1	7.9	6.9	8.5	8.3	7.7	3Q	
	4Q	8.0	8.5	7.5	8.8	7.9	8.1	7.9	6.9	8.6	8.4	7.6	4Q	
	1994 1Q	8.0					8.1			8.5	8.4		1Q 1994	

Unemployment Rate

(Percent, quarterly)

Actual	1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	4Q 1991	Actual
Forecast	1992 4Q	7.4	6.8	6.6	7.0	6.8	6.8	6.6	6.7	7.0	7.3	6.9	4Q 1992	Forecast
	1993 4Q	7.0	6.3	6.2	6.6	6.4	6.8	6.3	5.9	6.4	6.7	5.9	4Q 1993	
	1994 1Q	6.9					6.8			6.3	6.5		1Q 1994	



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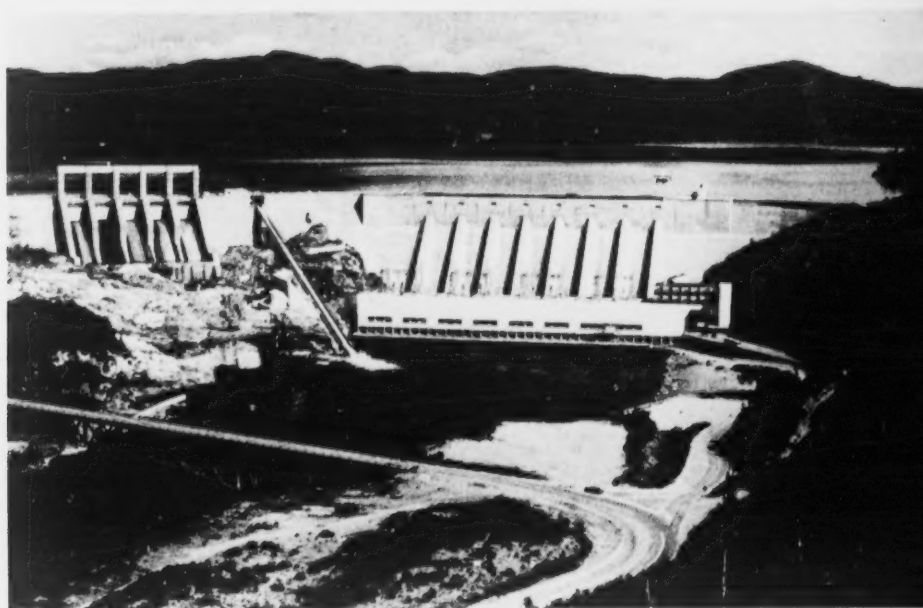
The Conference Board

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Volume 3, Number 5

May 1992

Economic Times



INSIDE:

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(pages 4-5)
- **Trends in U.S. Racial Composition**
(page 7)
- **Life and Death Among the Giants**
(page 6)
- **Advice to the Candidates**
(page 3)

Editor's Note

This month's issue offers another nice assortment of information and opinion, starting with suggestions our Colloquium members offer to the Presidential candidates on economic policy. Then Al Wojnilower discourses in his usual thoughtful fashion on the "credit crunch" and the pros and cons of alternative ways to organize an economy. Next a fascinating essay from *The Economist* on the mortality rate of large companies. Followed by a very short piece from The Urban Institute on how immigration is altering the racial composition of the population.

In the back of the book, as always, you will find the insights on the U.S. business cycle per our Stat File and Crystal Ball. Finally, my attitude about the Presidential campaign is nicely captured by Mencken's remark below.

Ed Fiedler

Maxim of the Month:

The basic fact about human existence is not that it is a tragedy, but that it is a bore.

H.L. Mencken

...Who Help Themselves

The tendency we have to translate every difficulty that an individual or a family experiences into a problem for society to deal with, and to think of every local problem as a national issue, seems more pronounced than ever. Sometimes the analysis is logical; a worker laid off during a recession, for example, is more likely the victim of the national economic slump than of the shortcomings of his or her individual job performance. But too often the tendency to socialize every issue is carried too far. Here are some recent examples:

1) This election year the candidates are directing most of their sympathy at the middle-class, whom they want to help by cutting taxes. As Herb Stein observed, these days nobody ever advises the American people (*a la* Bernie Baruch, some 70

years ago) to "work and save." The assumption is, rather, that individuals and families are powerless to help themselves, and it's up to the government to help.

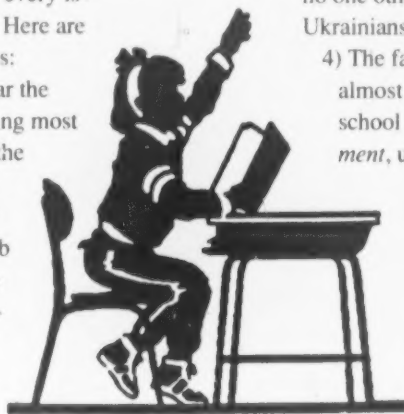
2) The U.S. record on infant mortality has improved over the years, but we trail many other industrial countries badly. Most of the time, fingers are pointed at the health care system in general and *the government* in particular. But according to Nicholas Eberstadt's persuasive analysis, the problem is mostly one of unwanted births and the unwillingness of many expectant mothers to abstain from tobacco, alcohol and drugs.

3) Richard Nixon recently criticized President Bush for not offering adequate assistance to the Confederation of Independent States. The media used Nixon's remarks as a basis to focus heavily on the "Who Lost Russia?" question—the idea that, if the former Soviet republics do not become successful democracies in the Western mold, the fault will lie with *the U.S. government*. But surely the success or failure of Russia, Ukraine, and Latvia, will be determined by no one other than the Russians, the Ukrainians, and the Latvians.

4) The failings of education are almost always attributed to the school system or to *the government*, usually for not allocating sufficient funds. But do schools with the highest per-pupil expenditures lead in educational attainment? No. There's no single answer, of course, but to me the most

important factors are the willingness of the students to learn and the readiness of parents to ensure that homework gets done.

What does this pattern tell us—other than that political scapegoating and pandering are still thriving? The sad lesson is that individual and family accountability is still downplayed in our society and, irrespective of repeated failures in the past, the American habit of turning to government for a solution is thoroughly ingrained.



Colloquium: Advice for the Candidates

Background:

Public opinion polls report widespread dissatisfaction among the American people these days, especially about economic matters. New York Governor Cuomo and others have urged the presidential candidates to offer a specific program—"an action plan"—to improve the economy.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Gail D. Fosler, Vice President and Chief Economist, The Conference Board; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

Question:

If you were advising one of the candidates, what would you recommend as the essential elements of such an economic plan?



Isabel V. Sawhill
The Urban Institute

Raise \$500 billion annually by 1997 via 1) a five cent VAT (necessities excluded), 2) a 50 cent gas tax, 3) fuller taxation of Social Security benefits, 4) a cap on itemized deductions, 5) health care cost controls, 6) lower defense spending. Use \$250 billion to eliminate the deficit and the rest to produce a totally restructured education system, research, training, and programs for disadvantaged children and their families. Be prepared to lose the election battle to win the ideas war.



Lyle E. Gramley
Mortgage Bankers Association

We face a grim economic future unless we increase national saving and investment dramatically. Greater private saving would be wonderful, but no one knows how. Let's get serious about the Federal deficit. Controlling health care costs is the top priority. And stop the nonsense about the sanctity of current tax rates. Taxing social security benefits fully seems sensible even to a person my age. Increasing the gasoline tax a dollar or more would both raise substantial revenues and conserve energy.



Gail D. Fosler
The Conference Board

The essential element is guts! First, cut the medical cost share of GDP and broaden coverage. This means less choice. Second, increase education content, cut the cost, and redistribute educational resources—in short, a mini revolution in the power structure of public education. Federal budget? It is as much a report card on the quality of decision-making as a policy instrument itself. Here, entitlement reform is the test.



Charles E. Walker
Charles Walker Associates

Pledge in the campaign to mount strong pro-growth policies through improved education and training, plus increased investment in infrastructure, technology and productive equipment. *Keep options open.* Upon election, convene an "economic summit" with legislative leaders of both parties. The goal: a bipartisan, five-year fiscal and tax plan to eliminate the deficit, cut taxes on productive investment, and fund education/infrastructure/technology programs—all to be enacted within "the first 100 days."

Organizing an Economy: Messiness is Best

by Albert M. Wojnilower



Problems of both demand and supply are liable to inhibit credit growth over the longer term as well as the near term. Credit demand will be slack because our underlying economic vigor is less. But we may fall short of even our more limited growth potential because of credit supply difficulties. These stem from the weakness of key financial intermediaries, itself part of a ubiquitous problem of economic organization with which the world does not know how to deal.

On the demand side, everyone can see that commercial real estate is vastly overbuilt and years from regaining health. Unoccupied office buildings dot the landscape and "blind eyes" (as a good friend of mine aptly labels the empty stores) stare vacantly out of even the fanciest shopping malls and streets. They would not be occupied at lower or even zero rentals, because the extraordinary employment and sales growth to which they are the too-much-too-late response has ended. That growth reflected the surge of young mothers into the labor market, and other demographic and societal factors that have largely run their course. These same forces, especially in their consequences for child-bearing and population increase, also raise serious questions as to the future vigor of housing and, for that matter, consumer demand in general. Further, this recession was atypical in that no particular pent-up purchasing or borrowing power has built up waiting to be unleashed.

Another longer-range source of demand weakness is the implosion of the

"military-industrial complex." Although military output peaked as early as 1987, it did not begin to plummet until the latter part of 1990 and especially after the Gulf War and the disintegration of the Soviet Union. More than any other factor, this collapse explains the economy's sudden loss of upward momentum last summer. Clearly the military sector is one hitherto dependable source of investment and credit demand from which much less will be heard.

Securities Markets, Yes; Banks, No

So much for credit demand. What about the supply? In past times of easy money, lenders urged sound clients to borrow more, took bigger chances on marginal borrowers, and recruited new borrower classes from among those formerly considered ineligible, such as lower-middle class households, women and students, or developing countries. This time around it is necessary to draw a sharp distinction between the performance of the securities markets, on the one hand, and financial intermediaries such as banking, insurance, and finance companies, on the other. The securities markets join lenders and borrowers through impersonal trades of standardized contractual claims. The issuers are, almost by definition, mainly the larger, better known, and well-established firms. The intermediaries, on the other hand, invest in relationships rather than securities, under contractual arrangements that are looser and more flexible than those governing marketable instruments. The intermediaries raise funds from the public on the drawing power of their own names, in order to lend to customers whose names cannot attract funds in the open market.

The securities side of the financial machinery has been functioning brilliantly. The lowering of short-term interest rates has steered huge quantities of funds, directly or through mutual funds, into

stocks and bonds. New issue volume has skyrocketed. The marketability of low-quality bonds has enjoyed a dramatic revival from the junk bond debacle. Also of particular interest is the proliferation of initial public stock offerings, surely an indication of a substantial hunger for funds on the part of small and new ventures as well as of greater willingness of investors to take risks.

The inescapable conclusion is that domestic banks have been forced to rein in their lending under supervisory and market pressures.

On the supply of relationship lending, however, the record is dismal. By past standards, and especially in view of the wide profit margins that prevail between the cost of money and loan interest charges, lenders have been remarkably diffident about seeking out business customers who might increase their borrowing. On the contrary, anecdotes abound about good credits who have been asked to pay down their loans.

Since early 1991, loans to the private nonfinancial sector outstanding at domestic commercial banks have actually been shrinking, in a decline essentially unprecedented in post-Depression times. By contrast, foreign-related banks in the United States, surely not without their own troubles and said also to be retrenching, expanded their loans by over 15 percent, suggesting that demand was hardly as dormant as their American counterparts claimed. The inescapable conclusion is that domestic banks have been forced to rein in their lending under supervisory and market pressures. The same is true for thrifts, life insurance companies, and business finance companies. This re-

strictive posture reflects a shortage not of money but of capital.

It was the regulators and the politicians, more so than the markets, who abruptly decided after years of ignoring or even promoting abuses, to apply capital constraints across the board. In 1988, the world's major central banks undertook to phase in formal credit-risk-based capital requirements on their commercial banks. Still more comprehensive requirements, intended to protect also against interest rate and market price risks, have recently been mandated by American banking law. Striving to meet the higher capital standards performance has been the principal priority for most major banks. Doing so has incapacitated relationship lending and opened a large gap in the credit marketplace.

The current low interest rates and wide spreads in favor of lenders may be regarded as a huge experiment in using such incentives to countervail the official capital crunch. They are surely helpful, but how much and how fast remains to be determined.

Markets and Relationships in Employment

Unknotting the kink in relationship lending is particularly vital at this juncture because of the peculiar nature of the unemployment resulting from the end of the Cold War. The freeing of disciplined, skilled, and experienced labor from military pursuits is quite literally what constitutes the peace dividend. Unless and until these individuals are reemployed in civilian pursuits, there will be no peace dividend to be reaped.

The reemployment of resources extends far beyond the military sector. It is no coincidence that massive job eliminations, paralleling in kind though fortunately not in extent those in the erstwhile Communist economies, should now be cascading through bureaucracies here in the United States, be they government, nonprofit, or business.

In the post-World War II United States, white-collar and unionized workers until recently could take more or less

for granted a seniority-based pay and/or career ladder, with layoffs or moves from one firm to another occasionally speeding or slowing but never ending the climb. This American version of lifetime employment has broken down, with economic, political, and social consequences that remain to be seen. The odd couple of a stock market setting record highs while consumer confidence plumbs new lows illustrates how these changes have disorganized the perception of our futures.

The collapse of our unwritten employment understandings is entirely analogous to the shift from relationship to market dominance in our financial arrangements. Vaguely specified and legally unenforceable mutual obligations are being replaced by sharply defined and impersonal market contracts. Such shuffling of people as though, in principle, they were securities is neither desirable nor feasible over the longer run.

How to Organize Economies

It is a commonplace of human evolution and history that better coordinated groups, those capable of mobilizing a finer and more productive division of labor, prevail over poorly organized cultures. Crudely expressed, as between two athletic teams equal in individual talent, the one with better teamwork (better coaching, if you prefer) will win.

Systems of impersonal exchange, that is to say, markets, are one powerful means of coordinating and disciplining human activity. But in reckoning with the future, markets can never be complete. No one can write a contract that responds enforecably to every future contingency. Nor can markets cope with all the human needs and desires that cannot be satisfied by impersonal exchange. A shortcoming of markets, daily observable in professional sports, is that their impersonal and individualist character tends to corrode teamwork.

But teams also have their drawbacks, most notably the tendency to become soft and corrupt. Successful teams are prone to exploit outsiders (customers, in

the business context), impelling them to join more loyal teams or form hostile teams of their own. As teams age, they are more likely to suppress innovations that would upset internal relations or threaten the leaders, and they are liable to turn the team into a means for feathering the nests of privileged members. It was not failure of its utopian ideology but rather such team degeneration that, in my judgment, brought down Communism. Such problems are hardly confined to Communist societies. To greater or lesser extent they afflict bureaucratic organizations everywhere, not least here in the United States. We are undergoing an economic adjustment that, though incomparably gentler, has much in common with the Communist world.

The tension between markets and relationships, both in our financial machinery and in our workplaces, reflects fundamental limits to perfection in human organization. Although markets and relationships are both essential to effective economic life, I believe society fails whenever either of them comes to dominate unduly. Neat orderly systems—all market or no market at all, all relationship networks or no relationships at all—are horrors. Only messy systems are good. But messy systems suffer from being complex and unappealing—in short, from messiness.

On the practical level my message is that we are rewarding multitudes of loyal and capable team members by putting in doubt their future or actually casting them out. Probably this purge was largely unavoidable. But we need relationship finance more than market finance—we need more messiness—to enable these skilled resources to form new teams. If they are unable to do so promptly, not only they but all of us will experience a peace dividend that impoverishes rather than enriches.

Adapted from "Markets and Relationships," a talk at The Conference Board's March 1992 Financial Briefing. Dr. Wójnilower is Senior Advisor at First Boston Asset Management.

Capitalism's Creative Destruction

Quiz: Of the top 100 companies on Fortune's first list in 1956, how many are no longer listed in 1992?

- a) About one-tenth.
- b) About one-quarter.
- c) About half.
- d) More than two-thirds.

For answer, see below.

At about \$22 billion, the market value of Microsoft, a 17-year-old computer-software firm, is now as great as that of General Motors, the world's biggest manufacturer. Many will dismiss this as a freak of the stock-market. How can a firm peddling shrink-wrapped computer discs, with only 10,000 employees and sales of just \$1.8 billion, be worth as much as the mighty GM, whose 766,000 employees produced cars and thousands of other goods that sold for \$124 billion last year?

The answer is simple, but has uncomfortable implications. The value of both firms reflects the best guess of millions of investors about how much profit each firm will earn in the future. Even millions of investors could be wrong, and they might suddenly change their minds if new information comes along. Yet neither valuation is a freak. GM is still big, but no longer mighty. Its future looks bleak. Though Microsoft's shares were not even quoted on the stockmarket until 1986, its future looks dazzling. Many investors are betting that it is the brash software firm without a single factory to call its own, not the vast manufacturing empire of GM, which has the best chance of surviving into the next millennium.

This is not as outlandish as it might seem. Big companies assume the trappings of solidity and permanence. Corporate headquarters, glorious or

appalling, are always among the most ostentatious buildings in any city. Big firms spend lavishly on anniversaries, preach tradition to employees, proudly publish their own histories and generally behave as if they have been around since time began. Most people crave some kind of stability, so this is understandable. It is also something of a sham. The most remarkable thing about big companies is not their longevity, but their transience.

Most of the company names which now seem like immutable fixtures either did not exist or were still obscure when our grandfathers were children. GM itself dates back only to 1908. Britain's biggest manufacturer, Imperial Chemical Industries, was born in 1926, when a group of smaller chemical companies merged.

Many firms which are now ubiquitous began even more recently. Sony, Honda and Xerox are post-war creations. Before the war Toyota was a textile-machinery company. Even most firms that can claim a longer heritage—General Electric, Coca-Cola, Nestle, Unilever, Mitsubishi, Philips, Daimler Benz—are not much more than a century old. They have managed to survive that long only by snapping up other companies and turning themselves inside out. RCA and Pan Am, once synonyms for innovation and business acumen, are gone.

Of the 100 firms heading Fortune's first list of America's 500 biggest companies, published in 1956, only 29 can still be found in the top 100 of its latest list, published on April 1st. Of the 100 biggest non-American firms listed in 1956, only 27 were still there in 1989, the last time the magazine published such a list. Within the span of one working life, well over two-thirds of the world's biggest companies were jostled

out of the way by faster-growing firms. Many lost their place after being acquired by a more successful firm. Some simply fell behind. Others disappeared altogether. A clue to the future: in Fortune's latest list, three of the top four places ranked by sales are taken by GM, Ford and IBM. Ranked by profits, their places are numbers 474, 472 and 473 respectively.

A Future Measured in Months

The disconcerting truth is that, in business, history counts for little. No matter what a firm's past triumphs, no matter what its size, its future is assured only by an order book usually measured in months, sometimes just in weeks. If customers stop buying even briefly, the grandest of corporate edifices quickly begins to crumble. A good reputation and established brand names can help insulate a company from some sudden shocks. But a new rival or a new technology can rapidly shift the ground beneath the best-known and most respected of firms.

In an apt phrase, Joseph Schumpeter described this as the "creative destruction" of capitalism. He was right to identify a propensity for continual change as capitalism's greatest virtue. Every GM in its death throes releases talent and cash for an upstart like Microsoft, which can make better use of them. The decline and fall of a corporate empire disrupts the lives of thousands. But propping up ailing giants, as governments everywhere are constantly asked to do, only delays the final deathbed scene, as well as the birth of the new.

Companies are not enduring institutions. Nor should they be.

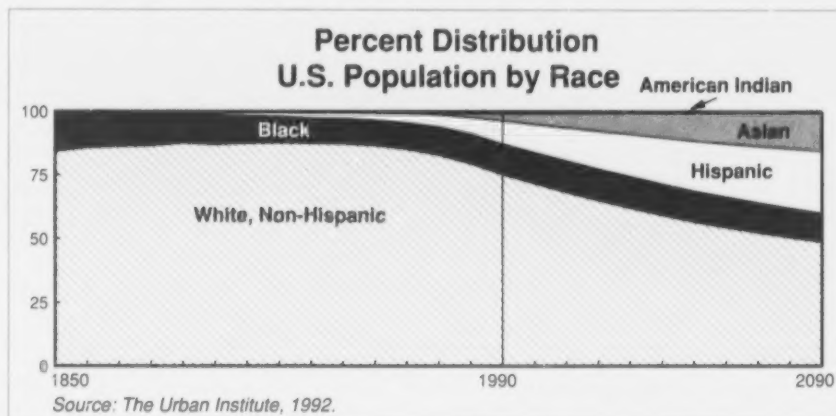
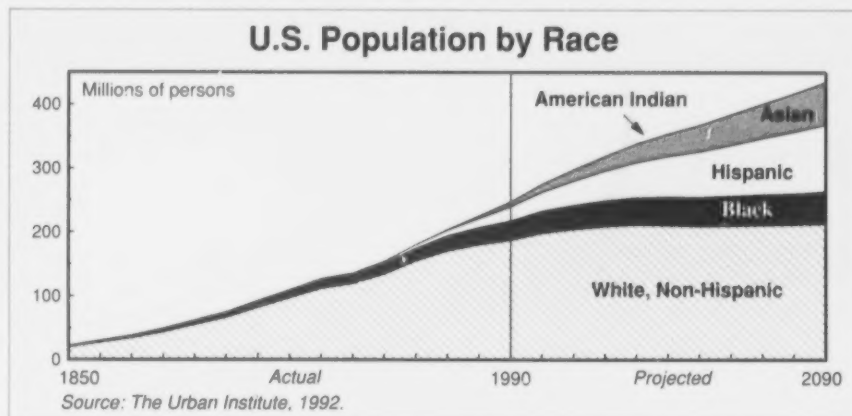
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Changes in Racial Composition of the U.S. Population

by Jeffrey S. Passel & Barry Edmonston



In 1990, about one-quarter of the population was minority; by 2090 about half of the population is projected to be minority.



Over the last century and a half, minorities have increased in number and in percentage of the total population. The recent, large increases in immigration, especially by Asians and Hispanics, have caused the composition of the minority population to shift substantially. The proportion of the minority population that is black has been dropping steadily; blacks now account for less than half the minority population for the first time. The U.S. population has changed from a predominantly white population with a black minority to a multi-cultural, multi-ethnic society.

Under the assumption that immigration will continue at roughly today's levels and with approximately the same racial/ethnic composition, we project a population exceeding 300 million in 20 years, reaching 400 million by 2070 and 430 million in 2090. In 1990, about one quarter of the population was minority; by 2090 about half of the population is projected to be minority. The Hispanic and Asian populations, in particular, will continue growing rapidly. The Hispanic population will exceed the black population and become the largest minority group in the United States by 2010.

Excerpted from "Immigration and Race: Past and Future Trends" in The Urban Institute's "Policy and Research Report," Winter/Spring 1992. Jeffrey S. Passel is Director of the Program for Research on Immigration Policy and Barry Edmonston is Senior Research Associate, both at The Urban Institute.

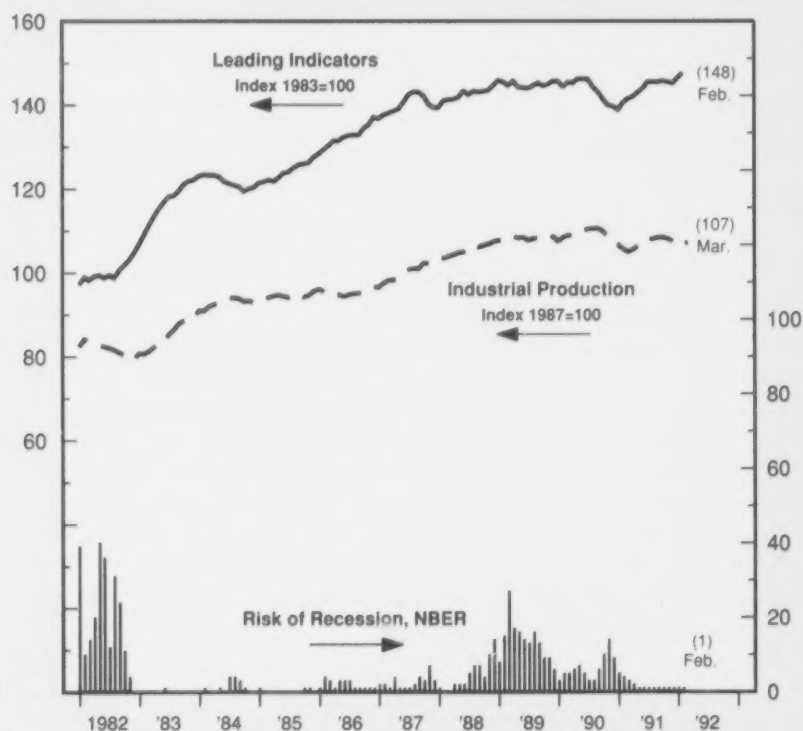
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Welcome Back, Modest Optimism

The conventional wisdom has changed over the past two months from "maybe recovery, maybe not" to "yes, recovery, but slow." Slow because defense output is declining (p.10), heavy construction remains moribund, current demographics are unfavorable, and the financial system still has credit problems. With that many negatives, what says there'll be any gains at all this year? The leading indicators (below) provide one persuasive signal. And where is the expansion impetus? In housing, inventory investment, and business equipment. Also, now that their expectations look better (p.10), consumers will bolster rather than retard this recovery. All this adds up, in my guess, to 3 to 3-1/2 percent growth this year, a tad higher than the participants in our forecast gallery (p.11) now see it. And prices? With unused capacity and unemployment staying fairly high, inflation (p.9) will remain near 4 percent during 1992. (Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

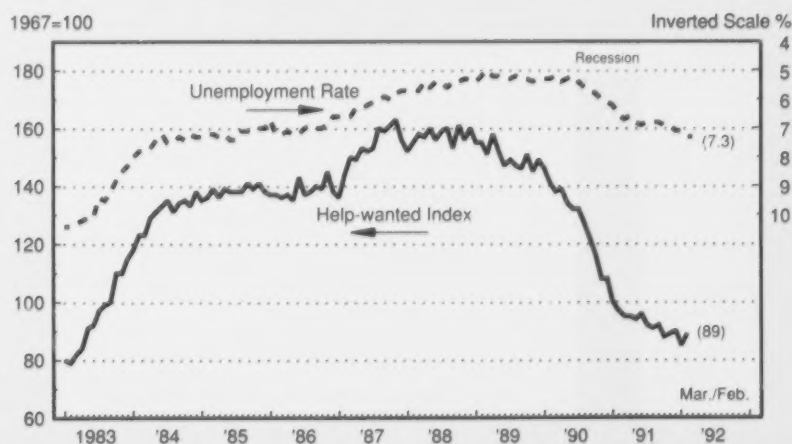
Early Warning Indicators

Leaders showing some renewed improvement.



Help-Wanted Advertising and Unemployment

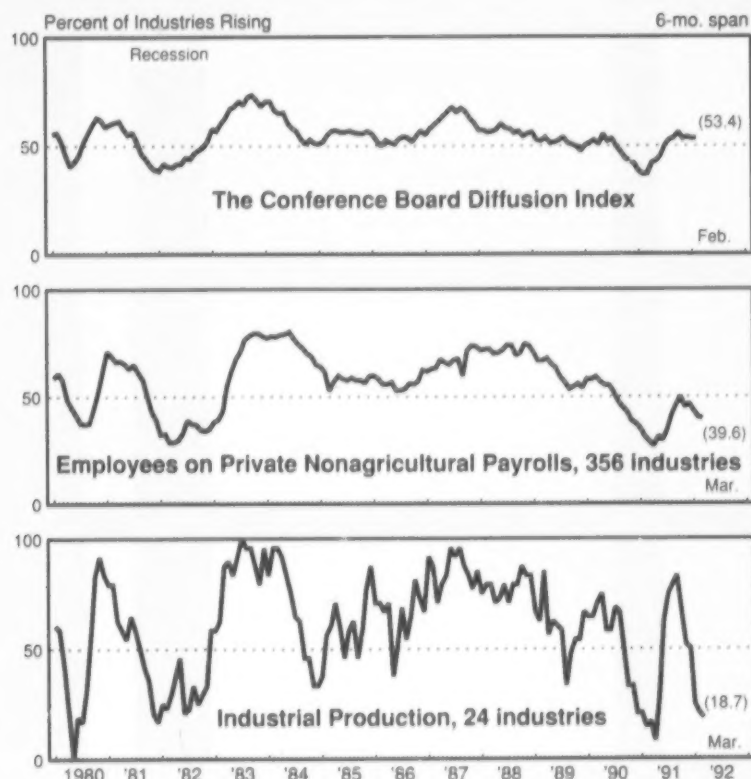
Labor market still weak.



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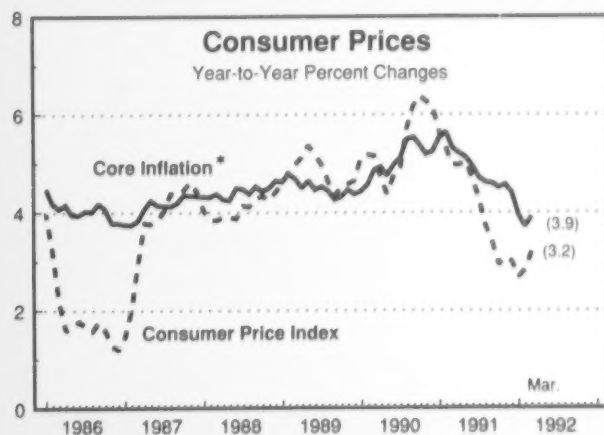
Indexes of Economic Momentum

Momentum indexes still weak.

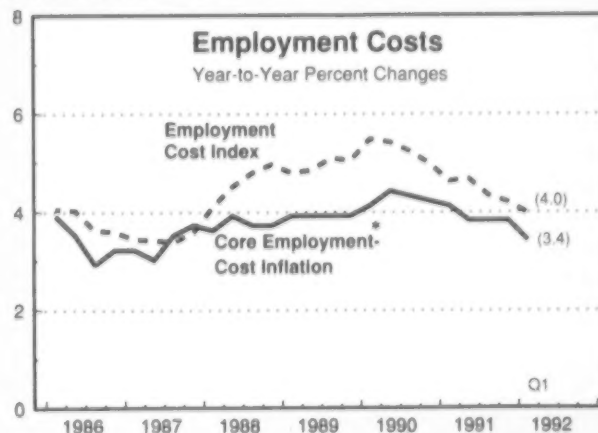


Core inflation remains under control.

Inflation Fundamentals



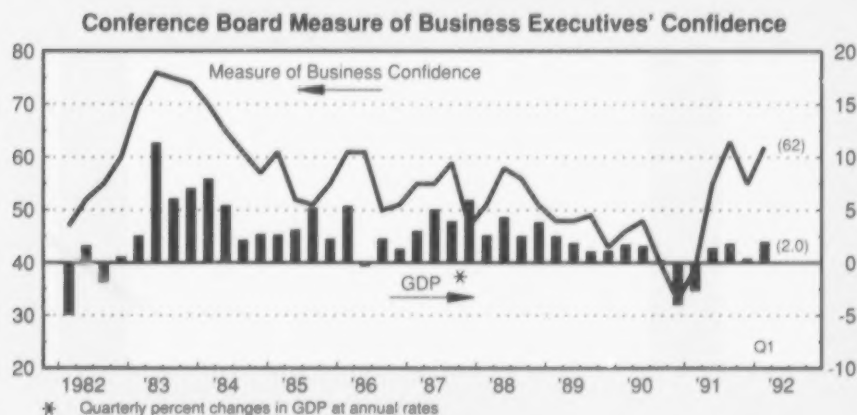
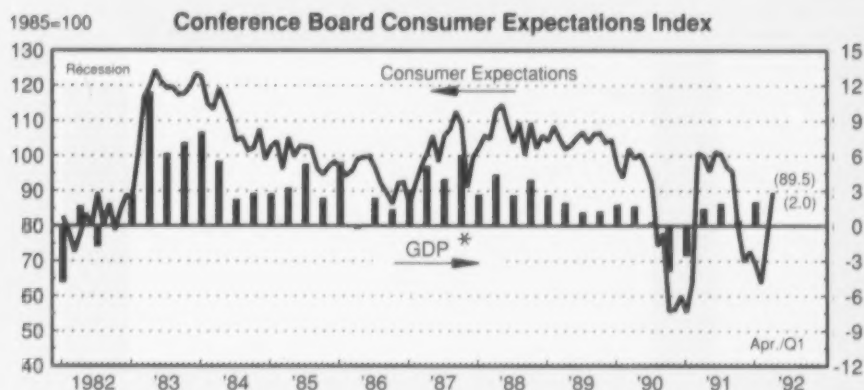
* Core Inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

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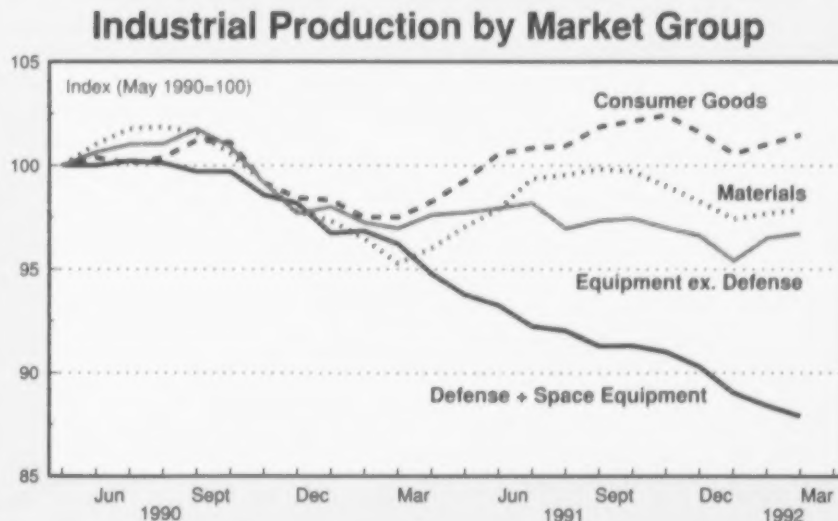
Confidence



Substantial recovery in consumer expectations.

Chart of the Month

While the economy has been struggling to mount a cyclical recovery from the 1990-91 recession, production of defense equipment has continued to decline. According to Al Wojnilower (p.4), "More than any other factor, this collapse [in military output] explains the economy's sudden loss of momentum last summer." The industrial production data shown in this chart bear out his statement persuasively.



Inside the Crystal Ball

	UCLA	MERRILL L.	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN - RSQE
Date of Forecast	Apr.	Apr.	Apr.	Apr.	Apr.	Apr.	Apr.	Apr.	Apr.	Apr.	Mar.

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	
Actual	1991 3Q	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	3Q 1991 Actual
	4Q	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	4Q
Forecast	1992 1Q	0.8	2.0	1.4	1.2	1.2	2.3	1.5	1.0	1.7	1.4	-0.3 1Q 1992 Forecast
	2Q	1.8	2.6	2.2	2.4	3.0	2.1	2.5	2.4	3.1	2.7	2.3 2Q
	3Q	2.7	3.4	2.8	3.9	3.3	2.6	3.9	3.2	2.8	3.2	4.2 3Q
	4Q	3.1	3.2	3.0	2.9	3.1	1.8	3.7	3.1	3.1	3.0	4.8 4Q
	1993 1Q	3.6	3.1	3.8	2.7	3.1	2.5	3.2	2.7	3.7	3.1	4.7 1Q 1993
	2Q	3.5	2.7	4.1	4.4	3.3	1.7	2.1	2.7	3.2	2.9	3.8 2Q
	3Q	3.1	2.9	3.5	-1.2	3.0	2.5	2.4	2.7	2.8	2.9	3.4 3Q
	4Q	2.7	2.8	3.2	4.1	2.7	2.0	3.9	2.6	2.8	3.4	3.3 4Q
	1994 1Q	2.6					0.9			3.2	3.0	1Q 1994

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Actual	1991 4Q	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0 1991 4Q Actual
Forecast	1992 4Q	2.7	3.5	3.4	3.0	3.1	3.0	2.7	2.5	3.1	2.7	2.6 1992 4Q Forecast
	1993 4Q	3.3	3.6	3.6	3.7	3.2	3.1	2.8	2.8	3.0	3.2	2.9 1993 4Q

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual	1991 3Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2 3Q 1991 Actual
	4Q	7.9	7.9	7.9	7.9	7.9	7.8	7.9	7.9	7.9	7.9	7.9 4Q
Forecast	1992 1Q	7.9	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.7 1Q 1992 Forecast
	2Q	8.1	7.9	7.8	7.9	7.8	7.8	8.0	7.7	8.0	8.0	7.6 2Q
	3Q	8.0	8.0	7.7	8.1	7.8	7.8	8.0	7.6	8.1	8.1	7.5 3Q
	4Q	7.9	8.2	7.5	8.4	7.8	7.8	8.0	7.5	7.9	8.2	7.5 4Q
	1993 1Q	7.9	8.2	7.6	8.5	7.9	7.8	7.9	7.4	7.9	8.3	7.8 1Q 1993
	2Q	7.8	8.3	7.7	8.6	7.9	8.1	7.9	7.2	8.1	8.4	7.7 2Q
	3Q	7.7	8.3	7.8	8.6	8.0	8.1	7.9	7.0	8.3	8.5	7.7 3Q
	4Q	7.7	8.5	7.9	8.7	8.0	8.1	7.9	6.9	8.4	8.6	7.6 4Q
	1994 1Q	7.8					8.2			8.4	8.6	1Q 1994

Unemployment Rate

(Percent, quarterly)

Actual	1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9 4Q 1991 Actual
Forecast	1992 4Q	7.4	6.8	6.8	7.3	6.9	6.9	6.6	6.5	7.0	7.1	6.9 4Q 1992 Forecast
	1993 4Q	6.8	6.3	6.2	7.3	6.5	6.8	6.4	5.8	6.4	6.4	5.9 4Q 1993
	1994 1Q	6.6					6.8			6.2	6.3	1Q 1994



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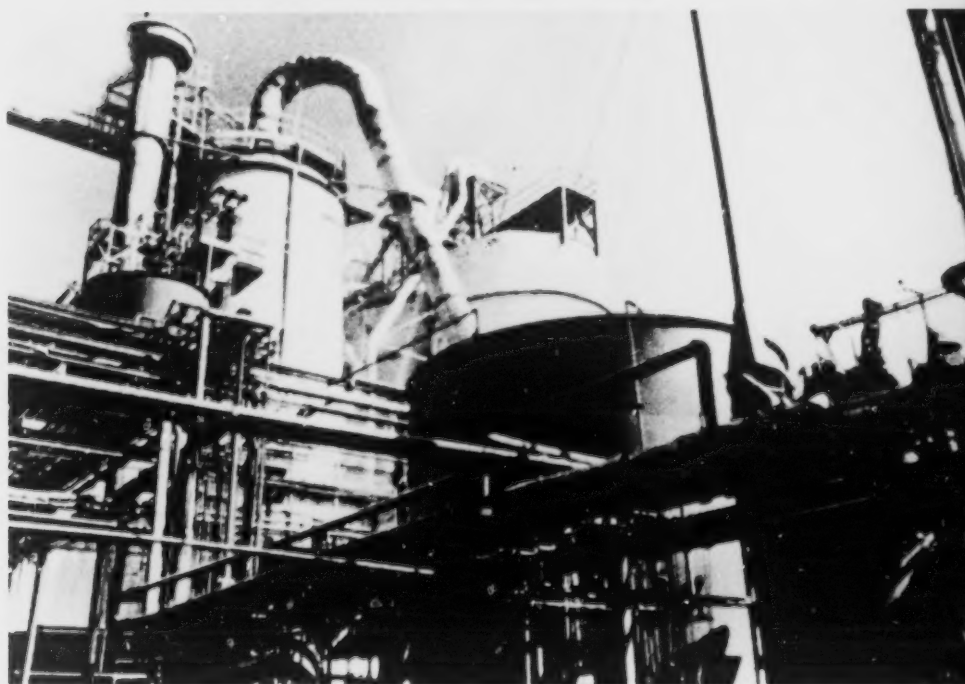


The Conference Board

Volume 3, Number 6

June 1992

Economic Times



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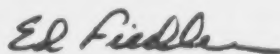
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Editor's Note

Recent travels provided me the good fortune to meet with some very able Latin American economists, from whom I was able to procure very interesting analyses of the dramatic changes taking place in Mexico, Argentina and Brazil, which are brought to you in very brief form on pages 4 and 5.

This month we also have some thoughtful comments from Paul Volcker on regional trading areas, and by Ned Gramlich on how to deal with our crumbling infrastructure. Then, in responding to another exceptionally complex question, our faithful Colloquium panel has again managed to compact an inordinate amount of information and analysis into some very short answers. And as always, our Stat File and Crystal Ball focus on the near term U.S. outlook.

Our cover illustration this month comes from DESC Sociedad de Fomento Industrial, Mexico. And, finally, if you're disappointed in the way most forecasts turn out, check this month's maxim, below.



Maxim of the Month:

**The trouble with our times
is that the future is not
what it used to be.**

Paul Valery

The Grand Conspiracy

No one has been able either to articulate or explain the deep dismay most Americans feel about many of our economic and political systems. They just don't seem to work right anymore. Probably the most widely believed explanation for our troubles is that there exist out there several selfish, corrupt, all-powerful groups who are depriving all us regular, law-abiding, trying-to-do-our-best people of what we rightfully have coming to us. They are paying us too little, taxing us too heavily, blocking our opportunities for better jobs, and keeping prices too high.

To some it's mostly the President's fault, or else it's Congress, or the bureaucrats, or maybe just "Washington." To others the villain is the Fortune 500 or "Wall Street." Still others blame the unions, the media, the lawyers, ... and so on. The list seems endless.

This idea seems plausible sometimes, because there *are* large and powerful institutions out there. Some of them are clumsy. Their leaders, being human, make mistakes that have unhappy consequences for others. Sometimes these groups exercise their power arbitrarily. On occasion they are irresponsible, even venal.

But while such misuses of power happen occasionally, they are *not* standard practice. They *do not* represent, as the Naders and Galbraiths and Greiders would have us believe, the normal course of events. Leaders of large institutions are no more sinful (or saintly) than the general citizenry and, in fact, they probably behave a bit better than the average citizen, simply because wrongdoing by institutions is more easily found out.

I should digress here to note that these institutions do not need me to vouch for them; they can take care of themselves quite nicely. Furthermore, I emphatically do not want to be thought of as a "fearless defender of the upperdog." But the evidence is clear, I feel, that their mistakes and misdeeds do not add up to a general, systematic abuse of power by the business community, or academia, or any of the other large institutions in American life.

Yes, some of them try to mislead the public regularly, although in their minds what they are doing is in the public interest. But by and large the ad agencies, the public relations firms, the TV news organizations, and the others do not succeed in pulling the wool over the eyes of their audiences. Yes, they fool some of the people some of the time, but rarely in large numbers and then not for long. And if you are among those taken in by the puffery of advertising, or the flimflam of politicians, or the perverted interpretations of Oliver Stone's "JFK," or the outright fraud of professional wrestling—well, then, you are just not paying close attention to the obvious misrepresentations, and the fault is as much yours as it is the swindlers who deliver the deceptive messages. Nevertheless, these hucksters are the exception rather than the rule in our society.

As a general rule, then, the large institutions in American life are not fleecing the public. They simply do not have the power to do so. The source of our widespread economic and political distress remains a mystery, but it is not the product of a grand conspiracy.

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Colloquium: Urban Policy

BACKGROUND:

"Urban policy"—the idea that large cities and especially the "inner cities" should be given special treatment by the Federal government in the form of public housing, enterprise zones, transfer payments to city governments, and so forth—is again being widely discussed.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Gail D. Fosler, Vice President and Chief Economist, The Conference Board; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

QUESTION:

Is it a good idea to focus certain policies on the large cities exclusively? If so, what programs do you advocate?



James Tobin
Yale University

Long before LA a group of 100 economists proposed \$50b. annually for states and localities for public investment and education. The mayors now request \$35b. Finance this by federal borrowing in 1992-1993, while we need demand stimulus, but by taxes or defense cuts thereafter. Much would go to inner cities. Stress integrated development plans engaging community leadership. Fully fund Moynihan's 1988 Family Security Act. Combine workfare with job guarantees. And please, President Bush, for once show guts and statesmanship: Sponsor federal gun control!



Gail Fosler
The Conference Board

Yes. National policies need to recognize the growing economic and social differences among states and regions as well as between urban and rural areas. Government efforts should encourage locally based development initiatives that build on local civic responsibility and are based on citizen and business commitment. The large income differences that are based solely on education also suggest the need for intensified education efforts and funding support.



Albert M. Wojnilower
First Boston Asset Management

Regardless what is done, those who can will persist in fleeing the inner city. Those left behind suffer and cause ever more serious problems. Remedial measures are urgent for everyone's sake. Through "enterprise zones" and otherwise, job openings (and job transportation) should be subsidized heavily. Wages should be supplemented by vouchers redeemable only for child-rearing purposes. Successful programs will enable more to escape. Those remaining will be fewer, but their problems and rage will intensify.

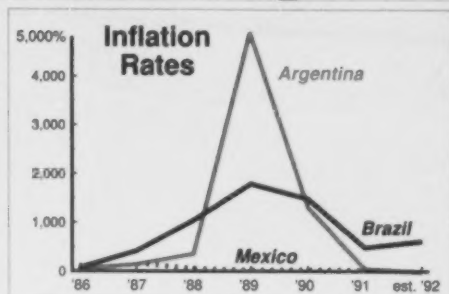


Robert G. Dederick
The Northern Trust Company

Do we need an urban policy? No. Do we need an anti-poverty policy? Yes. The poverty—economic and cultural, urban and rural—of the "underclass" is a national disgrace in this richest nation. How to eradicate it? First, see to it that the able-bodied have the opportunity, skills, and incentives (monetary and other) to secure jobs, jobs, jobs. Second, establish a minimum income tax to benefit those individuals unable to join the decently-paid mainstream. And, if (heaven forbid) all this costs some money, so be it. That's what taxes are for.

Mexico and Argentina Gain, Brazil Lags

After decades of inept and corrupt policymaking, many Latin American countries have turned their economies around decisively. Through monetary discipline, improved tax collections, privatization of government enterprises, opening the economy to imports, and deregulation, both Mexico and Argentina have made extraordinary progress. Inflation is the key (chart). In most respects Brazil has been the odd man out. Except for some gradual steps toward privatization, their market-oriented policy initiatives have either been poorly designed or not pursued with sufficient determination. As a result, inflation in Brazil is estimated at more than 600 percent in 1992, versus 19 percent in Argentina and 13 percent in Mexico.



Confidence Marks Mexican Outlook

by Jonathan E. Heath



The economic statistics show steady gains for the Mexican economy, and are the reason for the sharp improvement in the perception of investment risk. As a result, portfolio investment in Mexico has become more and more attractive, causing a large stream of capital flows into the country. Inflation has dropped from 30 percent annually at year-end 1991 to 17 percent this April. Interest rates have come down from 47 percent in March 1990 to 13 percent at present. And GDP growth has averaged 3.8 percent during the past three years after a long period of near zero growth during the 'eighties.

Strong private sector confidence in Mexico's economic outlook has made investment the main engine of growth throughout the past three years. Although the expansion slowed over the past two quarters, real GDP growth is expected to rise in the second half of the year. Reinforced expectations surrounding the eventual signing of the North American Free Trade Agreement (NAFTA) should further boost private sector investment. However, the expected boost in non-traditional exports as a result of NAFTA should not be felt until well into 1993 and then only gradually.

Although inflation has been coming down systematically during the past 18 months, the current 17 percent is still way above international rates. In Mexico's case this has become crucial, given the very stable foreign exchange market and a tendency toward a nominal appreciation of the peso exchange rate as a result of strong capital flows. The government has set a difficult-to-achieve target rate of 9.7 percent inflation for year-end. Capital inflows have caused an increase in liquidity and aggregate demand, complicating the fight against inflation. Most current forecasts of inflation for this year are between 12 and 13 percent.

Jonathan E. Heath is CEO and Chief Economist of MACRO Asesoría Económica S.C., Mexico City.

	GDP Growth	Inflation	Interest Rate
1986	3.6 %	106 %	86.7 %
1987	1.7	159	96.0
1988	1.3	52	69.7
1989	3.3	20	45.0
1990	4.4	30	34.8
1991	3.6	19	19.3
1992est	3.9	13	12.2

Astonishing Turnaround in Argentina

by Pedro Lacoste



Three years ago, Argentina was in the midst of hyperinflation. Decades of mismanagement of the economy had led to a closed, non-competitive, non-growth economy with inflation entirely out of control. When the Government ran out of financing sources to cover the gap between expectations and economic performance, hyperinflation was the result.

That experience now appears to have been the turning point, the end of a sad story and the beginning of a hopeful one. Politicians and society as a whole finally learned that structural reforms were badly needed to rebuild the economy. This is the only way to explain the astonishing policy changes of the past 3 years: privatization of many government enterprises, reductions of public expenditures, an attack on tax evasion, deregulation, and the opening of the economy internationally.

One especially important reform was the Convertibility Plan, launched April 1, 1991. Its core is a law firmly tying the local currency to the U.S. dollar. This means that the Argentine monetary base will always have to be backed by the same amount of international reserves in the Central Bank, and it prevents the government from printing money to finance fiscal deficits.

(Cont. page 5)

As of May 1992, the economic situation seems very much consolidated. The Government has shown fiscal surpluses during the past three quarters. A "Brady Plan" for the external debt was agreed upon with the commercial banks. The return of stability and confidence produced a domestic boom in consumption and sales. The stock market has rallied sharply since July 1991 and the pattern of capital flight has reversed into repatriation and foreign capital inflows.

The problems that still exist are relatively minor, and are the normal consequences of the successful stabilization program. The trade balance has deteriorated (although it is still in surplus). The Argentine peso is slightly overvalued in the foreign currency markets, due to capital inflows. How this overvaluation will affect the competitiveness of Argentine tradable-goods producers remains an open question, since the increases in productivity created by a stable, deregulated and competitive economy could compensate for much, perhaps all, of the deterioration in the exchange rate.

Pedro Lacoste is Senior Partner of ALPHA Estudio de Economía y Negocios, Buenos Aires.

	GDP Growth	Inflation	Interest Rate
1986	5.7 %	82 %	133.5 %
1987	2.2	175	229.4
1988	-2.6	388	445.8
1989	-4.5	4,930	5,477.3
1990	0.4	1,345	3,853.2
1991	5.5	84	101.7
1992 est	7.5	18	14.0

Brazil—Inflation Slower But Still Raging

by Julian M. Chacel and Marcio Ronci



Brazilian economic indicators point to a more stable economy in the short run. After mid year, economic activity should pick up gradually. This prospect reflects the low level of inventories, better export conditions, the expectation of a good harvest, and the improved sentiment of business executives thanks to the more stable economic rules set up by the government.

Inflation has also showed some improvement. Gloomy predictions of another period of hyperinflation failed to materialize. The business community is thus abandoning the idea of pre-emptive price increases, and believes the rate of inflation will start to decline slowly. Indeed, the monthly advance in the general price index fell to 18 percent in April from 27 percent in January. However, there is a clear resistance to a further reduction.

Policy. The present economic team deserves full credit for coming to grips with difficult choices and undertaking sensible policies under the worst possible conditions. Brazil has recently pledged the following to the International Monetary Fund: a primary fiscal surplus of 3 percent of GDP, austerity in public sector salaries, the lifting of most price controls, hefty real interest rates, and an opening up of the domestic market to imports. The goal is a gradual drop in inflation to 12 percent monthly by mid-year and 2 percent by December. If this trend materializes, confidence in the Administration will be restored, and there would be good reason to expect a business cycle upturn in the second half of the year. Of course, it has to be admitted that there is always room for skepticism.

Medium and Longer Term Prospects. The current situation is far from stable. Additional fiscal and monetary stringency is needed to bring inflation down permanently. Inflation stems from the fact that the central bank is not independent, but rather finances the Treasury's deficit. In Brazil, still today, the central bank is an agency serving the purposes of the Ministry of Economy and, unfortunately, the present Government has not given due attention to this aspect of policy.

Prospects for long-term growth are not bright. The two most important obstacles are a still-high demographic growth rate, particularly among the poor, and a large portion of the workforce with very low human capital and productivity. Investments in education and health may consume a large part of available savings. As a result, after a short period of fast growth, the economy will expand at a slower pace than its historical growth rate of 7 percent a year.

Julian M. Chacel is Director and Marcio Ronci is an economist at the Brazilian Institute of Economics, Fundacao Getulio Vargas, Rio de Janeiro.

	GDP Growth	Inflation	Real Interest Rate
1986	7.6 %	65 %	-0.1 %
1987	3.6	415	-0.3
1988	-0.1	1038	-0.4
1989	3.3	1783	1.4
1990	4.0	1477	0.9
1991	1.2	480	1.4
1992 est	2-3	612	4.0

On Regional Trading Areas

by Paul A. Volcker



I count myself as one of those who worry about regional trading areas. Presumably, they are justified as a move toward trade liberalization, but there is also a possibility for drifting into what could end up as restrictive blocks. Moreover, my gut feeling is that the danger will be increased by exchange rate volatility between regional areas. Now I said my gut instinct but I noticed at this conference a lot of professional economists were reporting their gut instincts. Moreover, as my own analytical capacities have declined over the years, my gut has increased.

The Common Market is the big example of a regional trading area. What drove the Common Market initially was concern about a cycle of warfare in Europe, about Franco-German rivalries, and how to deal with them. Later, as monetary unity assumed more importance, I don't think that Giscard d'Estaing and Helmut Schmidt, when they sat down and put the European Community (EC) on the road toward monetary unity, had long discussions about the nature of economic shocks—whether they were external or internal, real or nominal. It's a safe bet they had a larger vision of Europe and how to hold it together.

But even in emphasizing the importance of the political, I do think economists have the responsibility to subject the dreams of statesmen and the politics of politicians to the test of economic consistency and sustainability. Moreover, there is good reason to think that

in some case the economic argument might reasonably overcome the political argument.

Second, it seems to me that the extent to which the Common Market countries have moved toward a closer economic relationship reflects their concern about the disintegrating effects of flexible exchange rates. Much of the discussion at this symposium seems to me to reflect a naïve view of the practical efficiency of flexible exchange rates in dealing with economic shocks of any kind. The most important economic consideration in the vision of European monetary union was the perception that the potential exchange rate volatility within Europe, and the certain volatility between the European currencies and the dollar, would undermine prospects for coherent and free trade relationships within Europe. Perhaps they were unduly concerned, or perhaps they exaggerated the problem.

But from my viewpoint, it's hard to take great satisfaction in the operation of the floating rate system since the 1970s. We have seen increased volatility over time. Moreover, exchange rate fluctuations often seem unrelated to any discernible real or nominal shocks to the economy. And indeed, as I suggested earlier, there is some reality to the fear that volatility in exchange rates gives justification, politically or economically, to those who want to move toward protectionism.

It is very hard for governments, or for markets, to know in real time which shocks are real and lasting, which are nominal and passing, and which are reversible by macroeconomic policy and which are not. Much of the effort in textbooks to make these distinctions reminds me of the other distinction that a central banker always reads about in textbooks, namely that a lender of last resort lends freely when there is a liquidity problem,

but does not lend when there is a solvency problem. However, I have never found a central banker who could distinguish between a solvency problem and a liquidity problem in real time. We have a similar question here.

It's quite legitimate for the EC to fear the introduction of exchange rate flexibility into the European Monetary System (EMS). Such fear in the end might, based upon the actual operation of the floating system, shake the internal dynamics of the Common Market to the point that trading relationships themselves might break. Therefore, the choice of a common currency seems to me entirely rational; it's certainly a choice that I would make.

We could say that the EC is a special case. I was interested that those from Canada, Mexico, and elsewhere were very forceful about saying that monetary union in a North American free trade area is quite different. The political dimension is lacking. And if I were in their position, I would say what the Mexicans and Canadians are saying: these agreements do not call for a fixed exchange rate. It may be politically suicidal, and economically premature, to say anything else. But I also have the feeling that they doth protest too much. The peso was, in fact, fixed for decades, before a free trade agreement with the United States. It was a remarkable period of growth and stability and open capital markets in Mexico.

And it has been a long time since the Canadian dollar was fixed against the American dollar. But if I read the Canadian experience correctly, the exchange rate is a matter of some preoccupation from time to time in the conduct of Canadian monetary policy. I understand why it affects monetary policy. But the present system has not been perfect. There's been a chronic tendency toward higher interest rates, lower growth,

higher unemployment, and higher inflation in Canada. I will make a prediction that if we come back here in five years, you will find a fixed exchange rate among the peso, the U.S. dollar, and the Canadian dollar.

Third, I agree that because Europe is a special case, there's no point in crying about a regional trading arrangement in Europe. But one can question the extension to Eastern Europe and elsewhere. And one can certainly question whether the North America free trade area is inevitable, and what its implications are. I think that if we see large exchange rate volatility between the European bloc and the North American bloc, there will be a tendency to push toward more protectionism, not less.

We would be blind if we did not see the potential here. I hope it doesn't develop, but there is a potential for a kind of ganging up on Japan. Japan will certainly worry about that. But they will find it hard to react politically or economically because there isn't a natural economic region in the Far East. They don't have the political or economic background.

Finally, let me say that U.S. policy remains pivotal for several reasons. Partly because we have indirect control in the development of the North American free trade area, we can insure that it is outward looking, not inward looking. And I agree we should keep it open-ended, and not look just to Latin America. Let's look toward a Pacific Basin initiative.

Under the circumstances, this would be the most constructive way to make regional agreements outward looking instead of inward looking. It would not take a full-blown free trade agreement, but couldn't we improve dispute settlement procedures with Japan? Couldn't we develop better investment rules? In effect, couldn't we multilateralize the often antagonist Japanese-U.S. trading relationship?

Excerpted from his "Overview" of a symposium on *Policy Implications of Trade and Currency Zones*, Federal Reserve Bank of Kansas City, August 1991. Paul A. Volcker, formerly Chairman of the Board of Governors of the Federal Reserve System, is now Chairman of James D. Wolfensohn, Inc. and professor of international economic policy at Princeton University.

Crumbling Infrastructure? First Things First!

by Edward M. Gramlich



It is premature to devote more resources to infrastructure now. Take public highways, the largest component of America's so-called crumbling infrastructure. There is no doubt that certain highways and bridges are crumbling and congested—we drive on them and can observe the decay and traffic jams. But given the present inadequate way we price their use, it would be amazing if there were not decay and congestion. Consider the following list of pricing distortions:

Drivers of automobiles and heavy trucks treat most interstate roads as if they were free goods. State governments, responsible for interstate roads, are led by the structure of Federal grants to ignore the marginal benefits of highways for out-of-state drivers. While the decay of roads depends upon vehicle axle weight,

not only are tolls not set by this factor, but they sometimes actually encourage more axle weight. Thus there are no incentives for truckers to buy vehicles designed to conserve the highways. Finally, very few toll systems use time-of-day pricing to reduce congestion.

It may be that the nation's congested and decaying highways will require more resources for highway construction and renovation. But before shifting the resources, would it not make sense:

- to reform the matching structure of Federal highway grants,
- to charge tolls on interstate roads,
- to charge heavy vehicles in proportion to axle weight, and
- to place time-of-day charges on congested urban roads?

When all these measures are taken, there will be a much clearer picture of any true needs for highway construction and renovation. Similar comments could be made about airports, landfill dumps, and most other kinds of public capital. What the country should do right away is to revamp the matching structure of Federal construction grants and assign proper user charges for public facilities. Any large-scale attack on the public investment problem should await more sensible microeconomic policies.

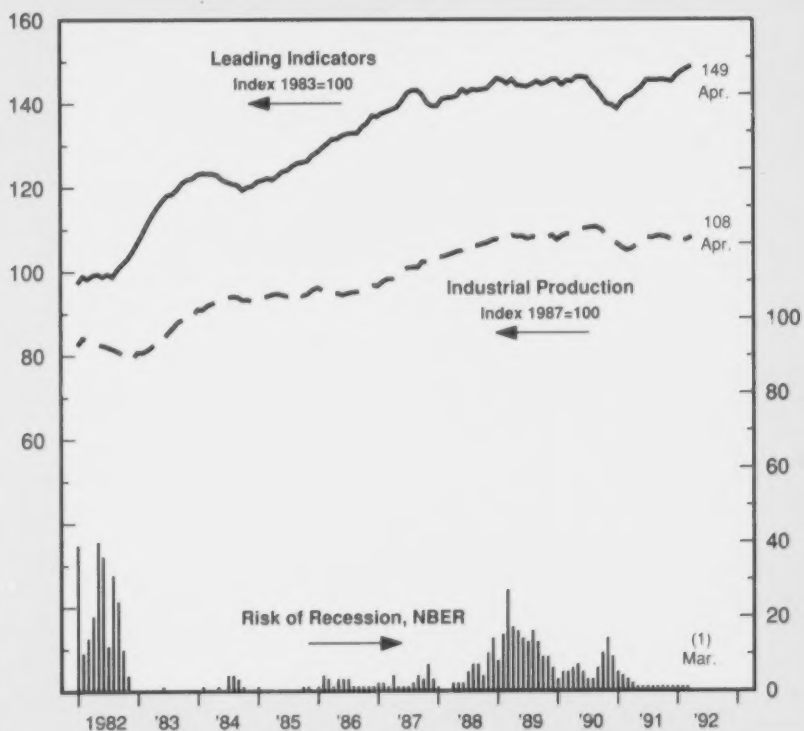
Excerpted from "Setting National Priorities: 1992", *The Journal of Economic Perspectives*, Spring 1992. Edward M. Gramlich is Professor of Economics and Public Policy at the University of Michigan, and former Acting Director of the Congressional Budget Office.

Conference Board Stat File

Take Your Choice

Recent economic statistics have tracked such a routinely satisfactory pattern that it is difficult to decide whether to be happy or bored. The cyclical upswing is secure, slower than past experience, yes, but clearly moving onto higher ground. Yet the moderate pace of advance and ample unused capacity tell us that for two years, probably, inflation will remain quiescent in the neighborhood of 4 percent—the neighborhood to which we have become accustomed over the past decade. This combination of an economy that keeps threatening to gather a bit more momentum and a calm inflationary environment is a happy, unmenacing prospect for most of us. But it does create a spicy environment for the bond market, which is alternately frightened by signs of a strengthening economy and reassured by the quietude of inflation. Accordingly, the outlook for long-term bonds is dicey and, if that's your playground, "you pays your money and you takes your choice." But, come to think of it, when has that not been true in the financial markets?!! (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

Early Warning Indicators



Early movers point toward further gains.

Help-Wanted Advertising and Unemployment

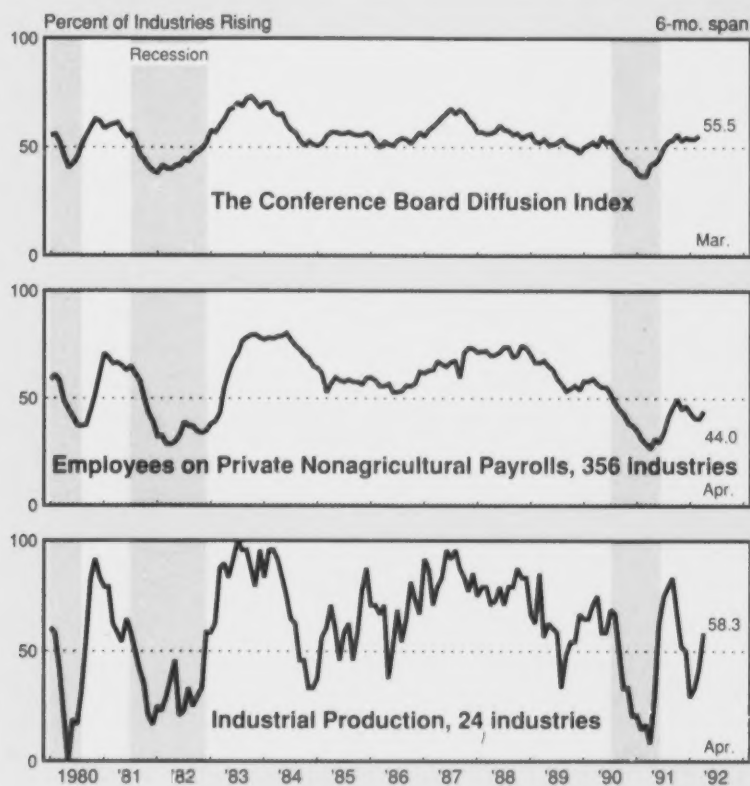


Hint of encouragement from help-wanted ads.

Conference Board Stat File

Indexes of Economic Momentum

Momentum indexes
in neutral gear.

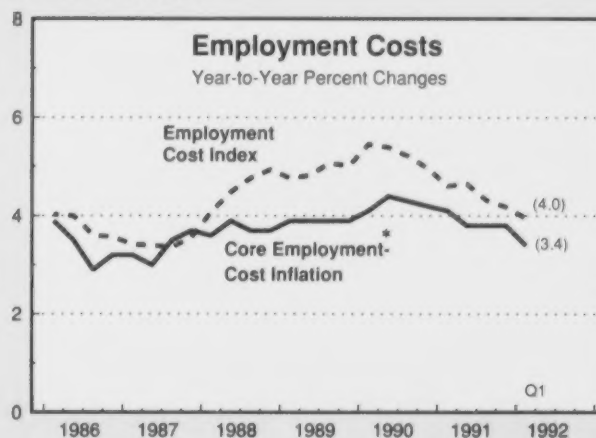


Core inflation
still looks cool.

Inflation Fundamentals



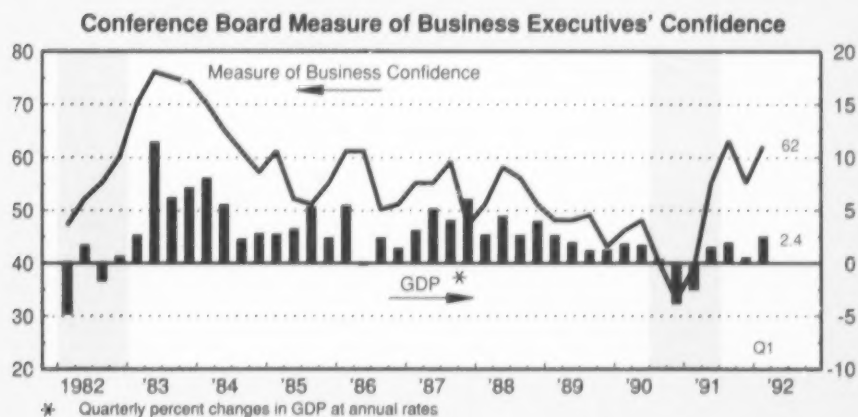
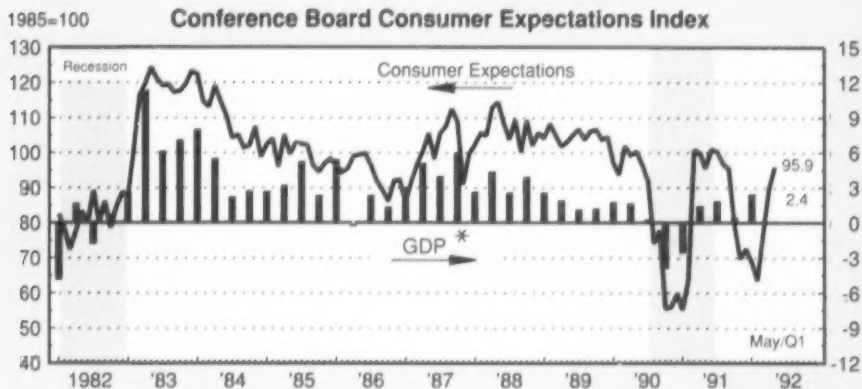
* Core Inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

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Confidence



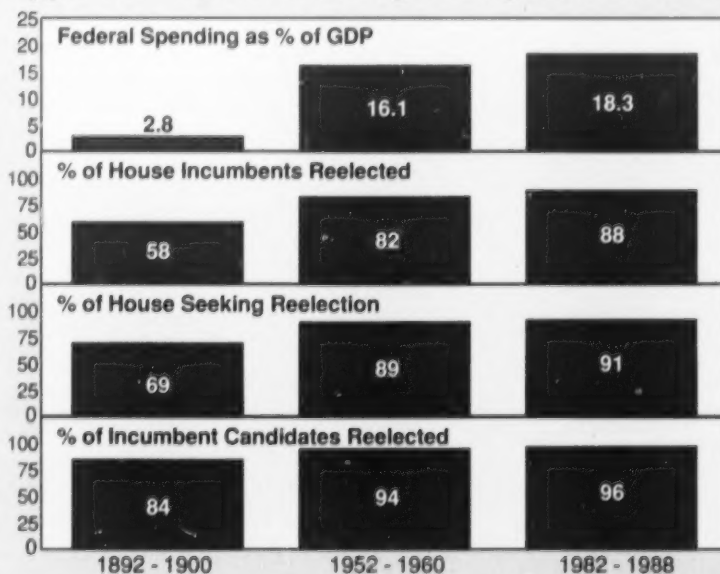
Sentiment data are encouraging again.

Chart of the Month

Arguing for term limits, Dwight Lee asks whether longer congressional terms cause larger government, or vice versa. He concludes that cause and effect flow both ways. As the chart shows, the retention rate of House incumbents increases in parallel with federal spending. The rising retention rate (panel 2) reflects two factors: the proportion of incumbents seeking re-election (panel 3) and the proportion of those seeking re-election who are successful (bottom panel). Both have increased over the decades.

Source: Dwight R. Lee, "Fiscal Pollution and the Case for Congressional Term Limits," Center for the Study of American Business, Washington University in St. Louis. Dwight Lee is Ramsey Professor of Economics at the University of Georgia. The figures on House retention rates come from John H. Fund, "Term Limitation: An Idea Whose Time Has Come," Cato Institute, 1990.

Bigger Government and Longer Congressional Terms



Inside the Crystal Ball

	UCLA	MERRILL L	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN - RSQE
Date of Forecast	May	May	May	May	May	May	Apr.	May	May	May	May

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

	%	%	%	%	%	%	%	%	%	%	%		
Actual 1991 4Q	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	4Q 1991	Actual
1992 1Q	2.0	2.0	2.0	2.0	2.0	2.0	2.0	1.0	2.0	2.0	2.0	1Q 1992	
Forecast 2Q	1.8	3.3	2.7	3.7	3.2	2.7	2.1	3.9	3.5	2.8	2.5	2Q	Forecast
3Q	2.7	3.1	3.5	3.6	3.3	2.3	3.9	3.1	3.8	3.4	4.0	3Q	
4Q	3.0	3.1	3.6	2.8	3.1	1.4	3.7	3.1	3.2	3.0	3.9	4Q	
1993 1Q	3.6	3.0	3.3	3.1	3.1	1.2	3.2	2.9	4.2	3.1	4.0	1Q 1993	
2Q	3.5	2.9	4.0	3.7	3.3	2.9	2.1	3.1	3.1	3.2	3.7	2Q	
3Q	3.1	2.6	3.4	2.5	3.0	2.7	2.4	3.2	2.5	2.8	3.3	3Q	
4Q	2.7	2.7	3.6	2.9	2.7	2.4	3.9	3.1	2.3	3.2	2.7	4Q	
1994 1Q	2.6			3.3		2.3		3.0	2.7	3.3		1Q 1994	
2Q						2.3		2.9	2.6	3.1		2Q	

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Actual 1991 4Q	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	4Q 1991	Actual
Forecast 1992 4Q	2.7	3.3	3.4	2.8	3.1	2.9	2.7	2.7	3.0	2.9	2.7	2.7	4Q 1992	Forecast
1993 4Q	3.3	3.5	3.6	3.1	3.3	2.9	2.8	2.9	3.0	3.1	3.1	3.1	4Q 1993	

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual 1991 4Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	4Q 1991	Actual
1992 1Q	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	1Q 1992	
Forecast 2Q	8.1	8.0	7.8	7.8	7.9	7.8	8.0	7.9	8.1	8.0	8.0	8.0	2Q	Forecast
3Q	8.0	8.1	7.7	7.8	7.8	7.8	8.0	7.8	7.9	8.1	8.0	8.0	3Q	
4Q	7.9	8.2	7.5	8.0	7.8	7.8	8.0	7.7	8.0	8.2	7.9	7.9	4Q	
1993 1Q	7.9	8.2	7.6	8.1	7.9	7.8	7.9	7.6	8.0	8.3	7.8	7.8	1Q 1993	
2Q	7.8	8.3	7.7	8.3	7.9	8.1	7.9	7.5	8.2	8.4	8.0	8.0	2Q	
3Q	7.7	8.3	7.8	8.3	8.0	8.1	7.9	7.4	8.3	8.5	7.9	7.9	3Q	
4Q	7.7	8.5	7.9	8.4	8.0	8.1	7.9	7.2	8.4	8.6	7.8	7.8	4Q	
1994 1Q	7.8			8.5	8.1	8.2		7.0	8.4	8.7			1Q 1994	
2Q						8.3		6.9	8.3	8.7			2Q	

Unemployment Rate

(Percent, quarterly)

Actual 1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	4Q 1991	Actual
Forecast 1992 4Q	7.4	7.0	6.8	7.0	7.0	7.0	6.6	6.9	6.9	7.2	6.9	6.9	4Q 1992	Forecast
1993 4Q	6.8	6.5	6.2	6.7	6.6	6.7	6.4	6.1	6.2	6.4	6.2	6.2	4Q 1993	
1994 1Q	6.6					6.7			6.1	6.2			1Q 1994	



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Economic Times



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Congenial**
(special center section)
- **The Car Insurance
Racket**
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Editor's Note

Many interesting items this time, ranging from the Industry Outlook Report (center section) to auto insurance fraud to a national service corps to advice from the most famous spymaster about how to deal with the Russians. We also provide, as always, our "Stat File" and "Crystal Ball," the former including a one-page chart story on mutual fund flows.

The cover photo comes to us courtesy of The Broken Hill Proprietary Company Limited of Australia. We trust all our readers have had or will shortly have a refreshing vacation.

Ed Fiedler

Maxim of the Month:

The optimist thinks that this is the best of all possible worlds, and the pessimist knows it.

J. Robert Oppenheimer

Rethinking a National Service Corps

by Bruce K. MacLaury



This nation is quite appropriately engaged in some deep soul-searching in the aftermath of the Rodney King case and the ensuing riots. While the acquittal of the Los Angeles policemen reemphasizes the immense importance of justice in a democratic society, the riots reemphasize the importance of law and order. Both kindle inflammatory questions about the role of race.

Rodney King's poignant question, "Can't we all just somehow get along?" demands a response not just in a renewed search for common values, but in reality of new opportunities. Where can we start? An idea that has received too little attention is an expanded national service corps to provide an alternative for unemployed teenagers faced with little more than street gangs and drug dealing. It is ironic that with the end of the Cold War, we are downsizing the armed forces, the very institutions that have the best record in our society of offering employment and training to disadvantaged youth. But what better time to devise a new civilian mission for the armed forces, to take advantage of the training skills of officers and non-coms, many of them minorities, as well as some of the training facilities that will otherwise have to be abandoned?

A national service corps could not only provide a structural learning environment for otherwise unemployed young people—offering them an opportunity to broaden horizons, learn valuable skills, and build values of discipline and responsibility—but also help protect the environment and rebuild the infrastructure. Combine such service with education credits for subsequent use to continue or seek advanced training, and one is really talking opportunity.

Moreover, like the armed forces, a national service corps can help bridge the gap between rich and poor and people of all colors. And with the provision of real opportunity, society need not feel concern or guilt for strict law enforcement directed against those who choose crime rather than opportunity.

Like most proposals offering this kind of opportunity, a national service corps would require tax funding. There is no free lunch. But it is hard to think of programs that promise so much in the way of payoffs as one that creates job opportunities and training for unemployed youth, a new mission for an underemployed army, a ticket to further education, an escape from crime-ridden city streets and housing projects, an environmental dividend, and experience in a cross-culture common cause that could help break down the barriers that separate us.

Excerpted from "Rediscovering the Common Good" in *The Brookings Review*, Summer 1992. Bruce K. MacLaury is president of the Brookings Institution.

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Colloquium: On Industrial Policy

Background:

The performance of the economy and the election campaign have renewed the controversy over the idea known as "industrial policy" or "national economic planning" or "technology policy."

Question:

Is this something the United States government should pursue? Which aspects of the idea should be emphasized? Which should be avoided?



Murray Weidenbaum
Center for the Study of American Business

INDUSTRIAL POLICY—UGH!

Proposals for industrial policy demonstrate the advantages of recycling.

Proponents only have to repackage and relabel the standard proposal for a more activist federal role in the economy. In turn, critics merely have to cite the long and sad litany of past efforts (ranging from the RFC scandals of the 1950s to the synfuel boondoggle of the 1970s). Why object to the ritual? It helps to create employment for economists at the profession's time of need.



Andrew F. Brimmer
Brimmer & Company, Inc.

The U.S. should *not* adopt an "industrial policy." The latter would require government officials to choose which products, processes, and production techniques would receive financial assistance. Because such officials are far removed from planning offices, research laboratories, and factories in the private sector, they lack the knowledge to make such choices. However the government should expand tax incentives for private R&D efforts by firms—which would continue to decide what, how, and for whom products and services are to be produced.



Don Conlan
The Capital Group, Inc.

If individual companies—with everything to lose—can't see the future, who thinks the government can? The government can, however, set fair limits on workmen's compensation litigation, find ways to constrain health care costs, stop trying to artificially support the U.S. dollar, forbid structural increases in the Federal budget deficit (to reduce long-term interest rates) and then stand aside and be surprised by the resourcefulness of American business.



John T. Dunlop
Harvard University

Wisdom is in the details, not in the sound-bites and clichés of winners and losers. Basic research, matched support for applied, non-military research and development, physical infrastructure and transport, energy policy, and skilled work force development—these are areas of industrial policy the government has long been in. The task for the future is a greater collaboration of the private and public sectors in focusing priorities and providing effective execution and applications.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Gail D. Fosler, Vice President and Chief Economist, The Conference Board; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

The Car Insurance Lottery

by J. David Cummins & Sharon Tennyson



The legal environment plays a critical role in driving up auto insurance costs. It is simply too easy and too profitable to file bodily injury liability claims on auto insurance. In most states—those with tort and low-threshold, no-fault systems—motorists experiencing minor accidents effectively receive a lottery ticket. The ticket gives them a high probability of winning some amount of money (like \$5,000) and a low probability of no gain. The lottery winnings are the motorist's share of a "pain and suffering" award. The price of the ticket is small.

Here's how it works: Driver A is involved in a minor accident where he sustains no injury but it is reasonably clear that the other driver is at fault. Driver A enters the lottery by visiting a lawyer who sends him to a cooperating physician, who conducts some tests and administers some treatment. The lawyer then files a claim against the driver who hit driver A. The cost of the lottery ticket to driver A is the physician's fee plus the time required to visit the lawyer and the doctor. The lawyer charges no fee up front but is entitled to a share of the lottery winnings (perhaps a contingency fee of 33 percent).

The insurer of the other driver now faces a dilemma. It suspects that driver A was not injured, but has received detailed documentation including a diagnosis and statement of treatment by a licensed physician. Furthermore, the claim is relatively small. The insurer calculates the expected costs of defending against the suit and finds that the costs

exceed the expected gain (the amount of the suit times the probability of a successful defense). It settles out of court, and driver A has won the lottery.

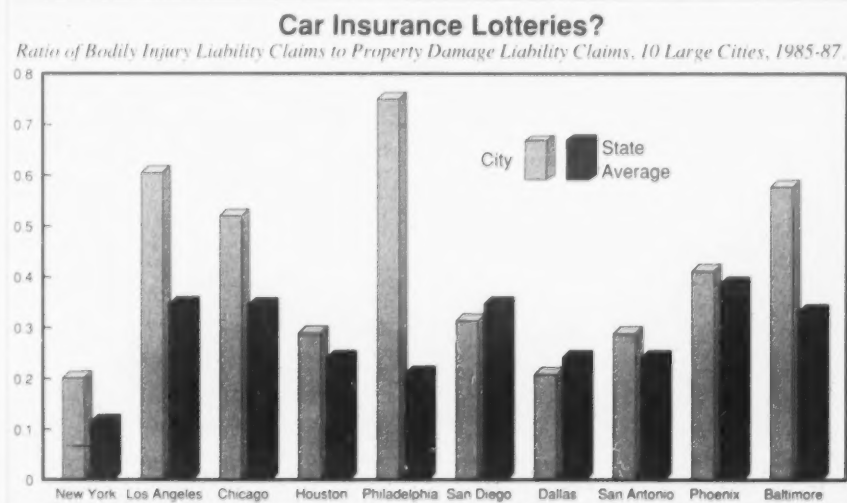
Several elements must be present to operate a successful personal injury lottery. First, the game must be played frequently to permit the lawyer to take advantage of the law of large numbers, because not all suits are successful. Second, there must be many physicians to choose from because of the low proportion of physicians willing to provide treatment for non-existent injuries. Third, driver A must be aware of the lottery and have easy access to a lottery attorney. Fourth, driver A must be able to play for a relatively low cost, which implies that the cost of the driver's time and the physician's up-front fee must be low. Fifth, the utility value to driver A of winning a few thousand dollars must be high. Finally, the court system must be sufficiently sympathetic to bodily injury claims so that the insurer's expected payoff from resisting the claim is lower than the cost of taking the case to court.

These elements suggest that insurance lotteries are most likely to develop in areas where accident frequency is high, physicians and lawyers are easily acces-

sible, information about playing the lottery can be widely disseminated, the utility value of winnings is high, and the cost of drivers' time is low. In short, insurance lotteries are most likely to develop in densely populated areas with economic problems and court systems that favor the plaintiff.

Statistical evidence consistent with the insurance lottery hypothesis is provided by calculating the likelihood of filing a bodily injury claim in relation to the number of accidents. The frequency of property damage liability (PDL) claims is the best available estimate of the relative number of accidents in different geographic areas. While not every accident leads to a PDL claim, one would not expect the rate of PDL claims per accident to vary significantly by location. PDL claims are much less susceptible to fraud because it is relatively easy to determine whether a vehicle has been damaged and effective mechanisms such as arbitration are in place to assign negligence without the necessity for a lawsuit.

The accompanying chart shows the ratio of bodily injury liability (BIL) to property damage liability claims for the nation's 10 largest cities and, for com-



parison, the average ratio for the entire state. In nearly every instance, the BIL/PDL claim ratio is higher in the large city than in the state as a whole. This evidence strongly suggests that car insurance lotteries are in operation in many urban areas. This evidence is particularly convincing in view of the fact that accidents occurring in urban areas typically are less severe than those in less densely populated areas because they occur at lower speeds.

A second source of evidence on the insurance lottery is provided by a detailed closed-claim study conducted by the Automobile Insurers Rating Bureau of Massachusetts. The Bureau investigated 597 bodily injury claims and estimated that over 30 percent of the claims involved explicit fraud or apparent overstatement of damages. The most successful insurance lottery was in Lawrence, a city long beset by high unemployment

and crime rates. A high proportion of the claims involved the same doctors and lawyers. Both sets of evidence persuasively indicate that fraud is widespread in auto insurance settlements.

What to Do.

Besides more vigorous enforcement, probably the best way to stop insurance lotteries is to adopt no-fault insurance with tort claims limited by a verbal definition (as in Michigan, for example, where "pain and suffering" suits are permitted only in cases of death, serious impairment of bodily function, or permanent serious disfigurement) or with tort claims subject to an economically meaningful dollar threshold. This type of no-fault regime eliminates the right to sue for relatively minor injuries, thus removing from the system the smaller claims, for which insurer resistance is not cost-effective. Insurers have a stronger economic incentive to resist

larger claims, so a smaller proportion of questionable claims is likely to receive compensation under no-fault.

In no-fault states that discourage pain-and-suffering suits, the number of bodily injury liability claims per 100 property damage liability claims increased only 3 percentage points from 1980 to 1989. By contrast, over the same span that ratio increased 7 percentage points in tort and add-on states, and 11 percentage points in states with low-dollar tort thresholds. It seems clear, therefore, that a well-designed no-fault car-insurance regime has great potential for curbing inflation in bodily injury liability premiums.

Excerpted from the *Journal of Economic Perspectives*, Spring 1992. J. David Cummins is Professor of Insurance and Sharon Tennyson is Assistant Professor of Insurance, both at the Wharton School, University of Pennsylvania.

Quotable Quote

Murray Weidenbaum on Defense Company Downsizing



Defense companies need to continue the painful downsizing now underway. They must maintain the financial ability to operate in a different market environment—or they will go under.

Most economic conversion proposals are characterized by naivete and wishful thinking. At best they are a diversion. At worst, they will dissipate the remaining assets of defense contractors. The numerous past attempts by defense contractors to use their factories and people to penetrate civilian markets have resulted in few successes. The abandoned projects run the gamut from canoes to coffins. Most of the undertakings have failed, either being closed down or sold at a loss. Defense companies are different from civilian companies. Proctor &

Gamble cannot make missiles and General Dynamics cannot produce soap or potato chips (at least not at competitive prices).

Trying to get commercial payoffs from military technology is invariably an enticing concept. But the past sad history of military contractors attempting to enter commercial markets should discourage the government from trying to forcefeed that process.

Individual defense firms need to understand that, like companies in other industries, they have no particular claim to maintaining their present size, or even to their continued existence—nor do their employees possess any special rights to the jobs now generated by defense spending. Most of these firms will find that a more modest scale of operations is also a more efficient scale in the decade ahead. This advice is consistent with the response of the chairman of Martin Marietta when asked by the Russians how to convert a tank plant into a refrigerator factory: Tear down the tank plant and build a new refrigerator factory.

Forcing defense contractors to try to penetrate alien markets is no favor to their employees—who would find themselves abruptly laid off when those ventures failed. Those now out of work are better advised to seek employment elsewhere. It is foolhardy to ignore the evidence. As a study by Battelle Memorial Institute concluded: "Detailed research has not identified even one successful product in our economy today which was developed through a military-to-civilian conversion approach."

Excerpted from *Small Wars, Big Defense*, Oxford University Press, 1992. Murray Weidenbaum is Mallinckrodt Distinguished University Professor and Director of The Center for the Study of American Business at Washington University in Saint Louis.

Le Carre on the Bear

John Le Carre's book, The Secret Pilgrim, closes with his famous spy, George Smiley, making the following discourse about the collapse of the Soviet Union to a group of young recruits to the British Intelligence Service.

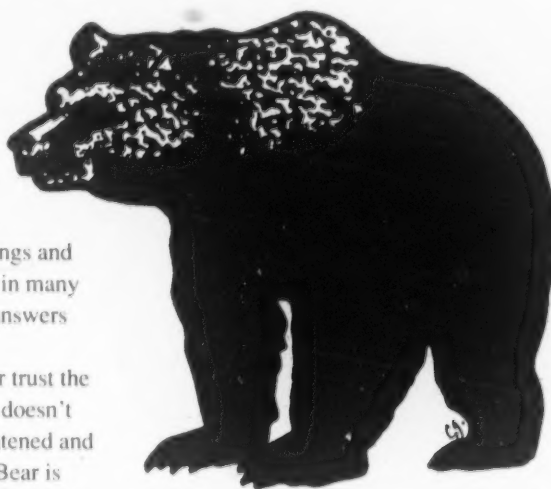
It was *man* who ended the Cold War in case you didn't notice. It wasn't weaponry, or technology, or armies or campaigns. It was just *man*. Not even Western *man* either, as it happened, but our sworn enemy in the East, who went into the streets, faced the bullets and the batons and said: we've had enough. It was *their* emperor, not ours, who had the nerve to mount the rostrum and declare he had no clothes. And the ideologies trailed after these impossible events like condemned prisoners, as ideologies do when they've had their day. Because they have no heart of their own. They're the whores and angels of our striving selves.

You asked me how we should think of Russia today. You ask, can we ever trust the Bear? You seem to be amused, yet a bit unseated, by the notion that we can talk to the Russians like human beings and find common cause with them in many fields. I will give you several answers at once.

The first is no, we can never trust the Bear. For one reason, the Bear doesn't trust himself. The Bear is threatened and the Bear is frightened and the Bear is falling apart. The Bear is disgusted with his past, sick of his present and scared stiff of his future. He often was. The Bear is broke, lazy, volatile, incompetent, slippery, dangerously proud, dangerously armed, sometimes brilliant, often ignorant. Without his claws, he'd be just another chaotic member of the Third World. But he isn't without his claws, not by any means. And he can't pull his soldiers back from foreign parts overnight, for the good reason that he can't house them or feed them or employ them, and he doesn't trust them either. And since this Service is the

hired keeper of our national mistrust, we'd be neglecting our duty if we relaxed for one second our watch on the Bear, or on any of his unruly cubs. That's the first answer.

The second answer is yes, we can trust the Bear completely. The Bear has never been so trustworthy. The Bear is begging to be part of us, to submerge his problems in us, to have his own bank account with us, to shop in our High Street and be accepted as a dignified member of our forest as well as his—all the more so because his society



and economy are in tatters, his natural resources are pillaged and his managers incompetent beyond belief. The Bear needs us so desperately that we may safely trust him to need us. The Bear longs to wind back his dreadful history and emerge from the dark of the last seventy or seven hundred years. We are his daylight.

The problem is, we Westerners do not find it in us naturally to trust the Bear, whether he's a White Bear or a Red Bear, or both kinds of bear at once,

which is what he is at the moment. The Bear may be in perdition without us, but there are lots of us who believe that's exactly where he belongs. Just as there were people in 1945 who argued that a defeated Germany should remain a rubble desert for the rest of human history.

The Bear of the future will be whatever we make of him, and the reasons for making something of him are several. The first is common decency. When you've helped a man to escape from wrongful imprisonment, the least you can do is provide him with a bowl of soup and the means to take his place in a free world. The second is so obvious it makes me a little intemperate to have to mention it at all. Russia—even Russia alone, shorn of all her conquests and possessions—is a vast country with a vast population in a crucial part of the globe. Do we leave the Bear to rot?—encourage him to become resentful, backward, an over-armed nation outside our camp? Or make a partner of him in a world that's changing its shape every day?

It's not only our minds we're going to have to reconstruct, either. It's the over-mighty modern State we've built for ourselves as a bastion against something that isn't there any more. We've given up far too many freedoms in order to be free. Now we've got to take them back.

So while you're out there striving loyally for the State, perhaps you'll do me a small favor and lean on its pillars from time to time. It's got a lot too big for its boots of late. It would be nice if you would cut it down to size.

Excerpted from *The Secret Pilgrim* by John Le Carre. Copyright © 1991 by John Le Carre. Reprinted with permission of Alfred A. Knopf, Inc.

Industry Outlook Report

Overview: Mixed Pattern, Moderately Optimistic



Edgar R. Fiedler
The Conference Board

The industry specialists contributing to this month's Report—in a pattern similar to the contributors of this past January and April—are on balance moderately upbeat about prospects for 1992 and 1993. Specifically, recovery in demand is expected for paper and other wood products, steel, petroleum, packaged foods, telecommunications equip-

ment and services, and in agriculture for grains and oilseeds. Weakness is seen, however, in oil and gas exploration and farm equipment purchases.

The international dimensions of the outlook yield a varied picture with an optimistic tilt. In pulp and paper, world recovery in 1993 is a prime force leading to much higher industry operating rates. Outside the OECD countries, petroleum demand continues to grow. U.S. exports of telecommunications equipment should also rise further. But in steel, weaker exports and slightly higher imports are expected to offset most of the pluses in demand arising from domestic sources.

The outlook for inflation, however, is mixed. There is of course a natural conflict of interest here, because the higher selling prices that boost profits in one industry add to costs in the next industry. Consumers, however, are mainly inter-

ested in price stability, and from that point of view there is unhappy news about wood products, petroleum, and packaged foods; in each of those sectors, prices seem more likely to rise than fall from here. But stable prices are expected for steel, and only a 1-2 percent increase is anticipated in 1993 for consumer foods. On balance, the 1993 inflation rate does not seem likely to deviate far from the present 3-4 percent rate.

The most encouraging news on prices is reported from the grass roots of the apparel business, where consumers have adopted a new psychology for the 1990s. Conversations at cocktail parties have shifted 180 degrees away from the old emphasis on expensive designer dresses. The refreshing new focus is pride in the latest bargain find. The apparel industry is, we trust, listening carefully.

Forest Products: Price Hikes Coming



Lynn Michaelis
Weyerhaeuser

The forest products industry has continued to be a good barometer of the general economic situation. Housing and wood products activity soured in the first quarter of 1992. The euphoria over what had appeared to be the first signs of a robust recovery has waned. Home sales have declined. Lumber prices have retreated from the peak levels of March. Export sales, which had been strong in 1992, have slowed dramatically. For instance, exports of linerboard (used in making boxes) are unchanged in 1992, after surging 14 percent in 1991.

Prospects for the industry over the next 12-24 months depend on two very distinct forces. The first will be the recovery in demand. Recent efforts to stimulate the economy through lower interest rates should help revive single family starts. As the recovery proceeds in 1992, consumer confidence should rebound, as will remodeling expenditures. Lumber and panel demand are expected to grow another 8 percent in 1993—or up nearly 20 percent from 1991 levels. Inventories are still very low.

The second force will be the limits on timber supply. There have been no public timber sales in the West Coast region on U.S. Forest Service lands for 18 months. Under recent changes, nearly 90 percent of federal land in Washington will be locked up permanently. Proposed harvest cutbacks will cause West Coast

lumber and plywood output to drop another 10-20 percent. When combined with restrictions in other producing regions, wood-product prices are expected to move up sharply in 1993 as demand recovers. In a classic example of how a competitive market works, prices will have to rise high enough to induce enough new supply to offset the shortage created by public policy choices that restrict supply.

Oversupply in the pulp and paper industry is being corrected. Prices have already bottomed for most products. The collapse in investment, combined with a world recovery in 1993, should lead to much higher operating rates by the end of 1993 and improving profits.

	1991	1992e	1993f
Lumber Demand (BBF)	43	46	50
Panels Demand (BSF)	24	26	28
Lumber Price (2x4, Spruce)	187	230	250
Plywood Price (1/2", South)	194	220	240

Petroleum: Price Turn Ahead



Brian O'Connor
Euenec Consultancy
Ltd (U.K.)

This July the German discount rate was raised to a level not seen since 1931-32. European economic activity will be held back and the ability of the United States to continue to call on international short term capital to finance recovery will be reduced. Meanwhile, in Japan, output continues to fall. World inflation is being reined in, but at a cost in jobs and output.

In this deflationary environment the petroleum industry is suffering with all

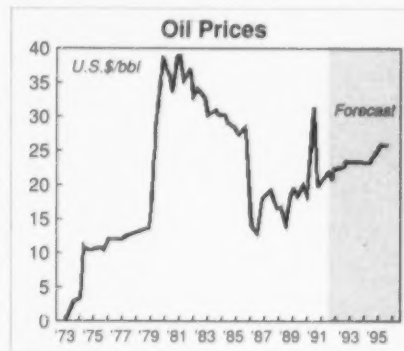
other energy producers—profits and share prices have fallen by 50 percent or more. In such a climate, what are the omens for the near future?

Petroleum demand outside OECD countries continues to grow, with the largest increment occurring in the Peoples Republic of China. Energy prices in real terms are at their lowest for nearly 25 years and energy demand per unit of GDP has now ceased to fall and may again be rising. Oil and gas will remain the preferred fuels while prices remain low.

In contrast, new supply is being affected. The problems of the former Soviet Union are well known and will not be resolved swiftly. Cutbacks in worldwide exploration programs and in numbers of skilled staff will restrict the rate at which new oil and gas developments will occur. The recent fall in the ratio of oil reserves to production will thus continue. Only the Middle East offers any hope for major additional oil supplies, but, here

too, existing capacity is becoming obsolete and in need of enhancement.

Global inventories are adequate for the weak demand now being experienced. Recent price movements are consistent with average global cover for all users staying in the range 85-95 days. The maintenance of current OPEC restraint seems likely to result in trading values oscillating through a range of \$18.50 to \$25.00 for Brent Blend, with WTI and Dubai crudes approximately \$2.00 above and \$1.50 below Brent respectively.



Food Industry: Still Growing



Len Teitelbaum
Merrill Lynch

Without exception, participants in the packaged food industry have been hurt by the recession. Normal consumption patterns have been disrupted, private label goods have gained market share and an economically battered consumer has made "low price" the leading brand name. The supermarket, having lost customers to the Club stores, has ex-

erted a "share-the-pain" strategy in trying to protect margins on lower volumes.

Considering the above, the outlook is probably more favorable than one would assume. While it may be too early to predict the end of the recession, statistics on purchase patterns indicate conditions may be stabilizing and in some cases private labels are giving up market share to branded goods. We have also seen evidence of selected price increases lately.

It seems axiomatic to say "no matter what, people have to eat," but profitability on what is sold may be more relevant. For 1993, the key to profits will be marketing expenses and cost containment. Packaged food companies must spend smarter to increase operating margins. Prices can be raised (as the cereal industry did) but "judiciously" is the byword.

Food companies admit that 1992 was indeed a "wake-up call" and many are reacting accordingly. We look for slight margin improvement in 1993.

Normally we would project the industry to gain 11-13 percent with one or two companies at 15 percent. In 1992 we will be happy with 10-12 percent and in 1993 hopefully returning to 11-13 percent annual rate as the year unfolds. Europe will still hold fascination for U.S. companies and we expect to see acquisitions by CPC International, Campbell Soup and Hershey; before 1993 ends at least one large merger may be seen. In the meantime marketing alliances or strategic partnerships are forming with increasing regularity. Depending upon the company this could raise the growth rate one-half to one percent in any given year.

Steel: Modest Gains



Elizabeth A. Bossong
Economist

Winning the Cold War has concentrated our focus on the domestic scene. Our problems are magnified under the lens, and encourage the new pessimism. Nevertheless, despite concerns about the productivity trend, deficits, the S&L debacle, and other events, we should see economic growth of about 2 percent this year and more than 3 percent in 1993.

Changes in steel will be modest. In 1991, steel consumption fell by 6.5 million tons, and an inventory swing from accumulation in 1990 to liquidation cut

another 3 million tons from demand. However there was a solid improvement of 4 million tons in the steel trade deficit. Shipments, as a result, dropped by only 6 million tons to 70 million.

This year, private nonresidential building activity will continue to weaken, offset by further gains in public construction and housing. Industrial machinery output will be flat for the year. Improving auto and truck sales combined with low inventories are driving automotive production schedules upward, and total 1992 output will increase by more than a million units.

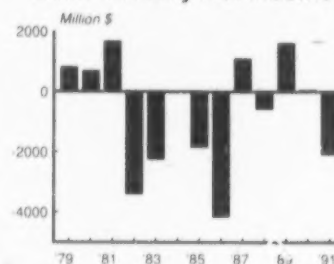
Total steel usage should increase by nearly 1-1/2 million tons. A reversal of last year's inventory run-off will add another 1-1/2 million tons. However, weaker export demand and slightly higher imports will offset most of those pluses. Total industry shipments will be little changed at 79-80 million tons.

Stronger economic growth in 1993 reinforced by the steel-intensive capital

goods markets and continuing gains for autos and appliances will permit a healthier 3 million-ton increase in actual steel consumption next year. Industry shipments should reach 82 million tons.

Steel earnings collapsed in 1991, with lower volumes and price cutting driving net income deeply into negative territory. Those losses should narrow this year because of continuing cost reduction. Next year should see a return to modest profitability with improved volume and stable prices.

Steel Industry Net Income



Source: American Iron and Steel Institute

Apparel: Ever Changing



Ed Johnson
Johnson Redbook
Service

The frequent downturns in the apparel industry are well known and can arrive quickly with little forewarning. They are caused by unpredictable cutbacks in consumer spending on apparel, periods of unseasonably warm or cold weather, and excess inventories at retail. Weather plays an increasingly important role as consumers buy closer and closer to needs rather than according to the calendar. Sweaters and other cold weather gear will have a slow start for

the fall if warm balmy weather expands past September. Conversely spring and summer apparel won't be bought early in April and May if the weather stays frigid.

We have gone through two of these mini slowdowns in the past nine months. One last fall as general merchandise retail sales slowed to year-to-year increases of 2 to 3 percent when financially strapped consumers turned to the goodies already in their closets as opposed to what is normally an ever present lust to have something new. This craving for newness returned starting on December 22 with retail sales jumping smartly ahead through February. This rebound was aided by spring-like weather in the first two months of 1992. Then apparel sales declined through the end of May, largely due to unseasonably cold weather. However, June sales improved slightly as warm weather arrived and pent-up consumer demand took over.

More important is the recent major change in consumer psychology. In recent years these changes have run in ten-year cycles. The period of the 60's was a dress-up era with a strong emphasis on brand names. This reversed in the 70's with a dress-down era—holey jeans and sloppy shirts were in vogue. There was a strong trend toward buying at thrift shops and little desire for brand names. The 80's emphasized dress up, brand names, high-priced designer labels, and snob appeal. The 90's have ushered in a new era of so-called "reverse snob appeal." The talk at cocktail parties is about the latest bargain purchased rather than the expensive new designer label. This trend is putting downward pressure on apparel company margins as stores look for lower prices. Department stores and high priced specialty stores are suffering. Conversely, discount stores, warehouse clubs, and factory outlets are flourishing.

Telecommunications: Renewed Expansion



Ken Miltzer
AT&T

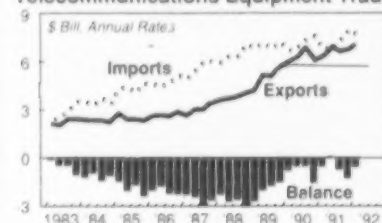
Spending for telecommunications services increased right through the 1990-91 recession, but the equipment side of the industry was hurt by cutbacks in the local exchange carriers' construction programs. In the long distance market, message growth in the current cycle has been similar to what occurred during previous cycles (see chart). It slowed through late-1991, but is now moving back up along with the recovery in the overall economy. If it continues to follow the pattern of earlier cycles, growth will

accelerate further—to the 10-12 percent range by 1993.

Growth in the number of telephone lines in service—one of the factors affecting the local carriers' revenue growth and their spending for new equipment—is also moving back up after slowing during the recession. The growth in lines is considerably slower than the growth in long distance volumes, but in 1993 it should get back to about the 3 percent rate it had been following before the recession drove it down to 2 percent.

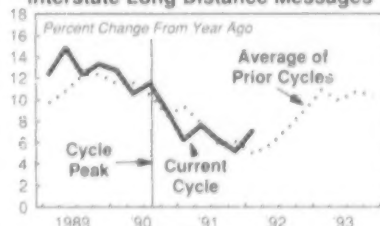
Since the local carriers' spending for new equipment fell during the recession, export sales became an important source of growth for domestic manufacturers. In-

Telecommunications Equipment Trade



creasing exports have also been the predominant force behind the improved trade balance in telecommunications equipment over the past three years (see chart). Early in 1992, exports were up 13 percent from their year-ago level, and the trade deficit was running at a \$500 million annual rate (down from a peak deficit of \$2.8 billion in 1988). Exports should continue to increase, contributing to renewed gains for domestic manufacturers, as economic growth abroad picks up later this year and in 1993, and as U.S. access to many foreign markets improves.

Interstate Long Distance Messages



Agriculture: Food Prices Not Threatening



John Schmittner
Schmittner Associates

The food sector is increasingly sensitive to recession as more highly processed products dominate supermarket shelf space. Food prices at retail increased only 1 percent in the past 12 months; food at home rose even less. Declining meat prices, with more pork and a perennial increase in poultry meat, also contributed to stability. Increased water

supplies in the West aided fruit and vegetable production.

U.S. and world prospects for 1992 grains and oilseeds are clouded by early yield losses in the United States, uncertainties about the former U.S.S.R., and concern about a weak monsoon in Asia. Conditions in late July support harvests equal to or slightly above requirements. If weather conditions until fall are favorable, food inflation in 1993 will be as low as 2-3 percent. On the other hand, if Asian grain harvests should decline sharply, with stockpiles depleted, food prices worldwide could add to inflationary pressures by year end. Thus far, however, U.S. food and agribusiness sectors have been unable to raise prices materially in the recent highly competitive, weak demand environment.

Farmers are retrenching as income prospects fall 15 percent below the record 1990 level. Spending by farm families is not likely to help farm area economies recover this year or next. Large tractor sales are 17 percent below the slow 1991 pace. Grain harvester sales are off nearly 50 percent. The farm economy is financially strong, however, with aggregate debt down 30 percent from the 1982 peak of \$200 billion. Nothing like the 1983-87 farm recession is on the horizon. The outcome of the 1992 election is unlikely to affect the farm economy materially. Budget pressures, however, will continue to force cuts in farm subsidies.

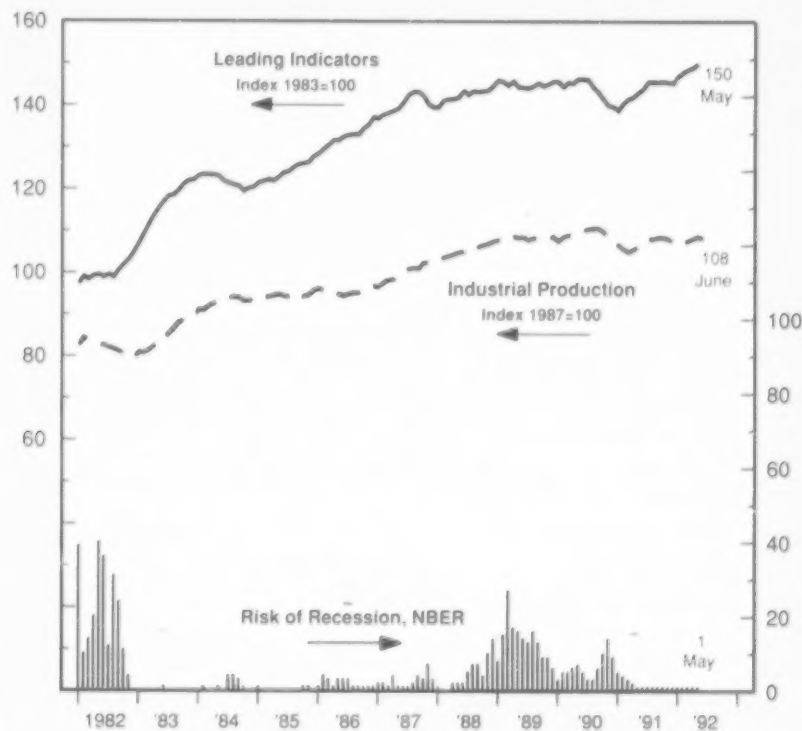
	1991	1992e
Farm cash income (billions)	\$57	\$53
Retail food prices (% change)	+2.9	+1.2

Conference Board Stat File

Still More Optimism

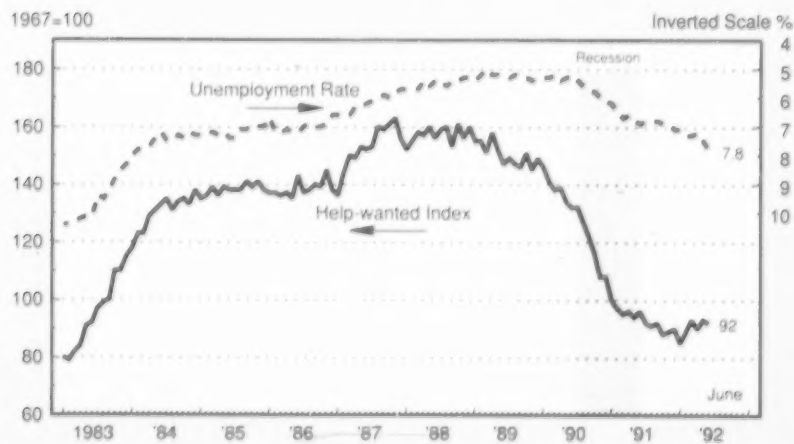
The ink was barely dry on our conclusion last month that the U.S. business cycle was tracking a "routinely satisfactory pattern," when that judgment was demolished by June's negative employment-unemployment report. Nevertheless, despite the rampant pessimism that pervades the country, or at least the media, we still believe the economy remains on a slow but self-sustaining recovery. Furthermore, with uncharacteristic boldness, we will venture another optimistic forecast: Assuming no major energy supply shock or similar event, inflation should continue to be quite benign for several years ahead. Why? Because the recovery is slow and idle labor and capital are plentiful. This combination tells us it will be a long time before the economy sees unemployment low enough and factory operating rates high enough to blunt the strong competitive pressures that are keeping wages and prices under firm control currently. In fact, it could easily be the second half of this decade before the economy pulls close enough to full capacity to trigger a new inflationary speed-up. (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

Early Warning Indicators



Leaders look lovely.

Help-Wanted Advertising and Unemployment



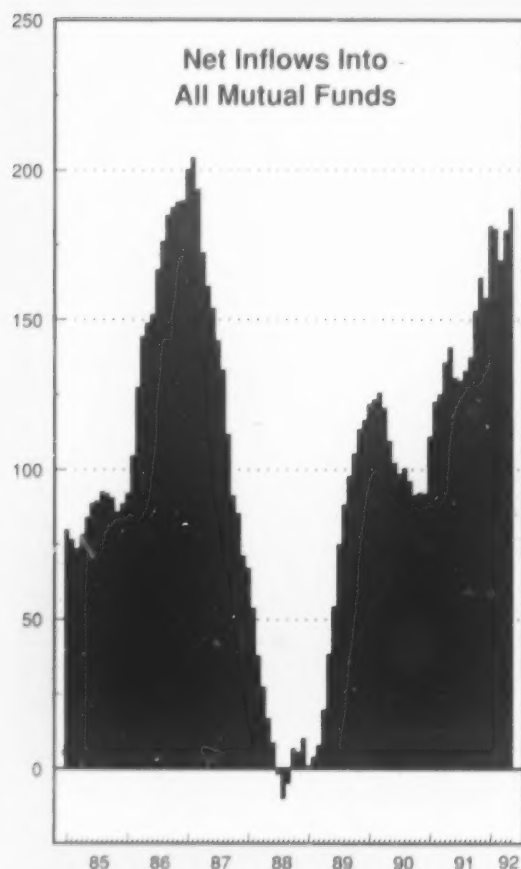
Labor markets even weaker.

Conference Board Stat File

Chart of the Month

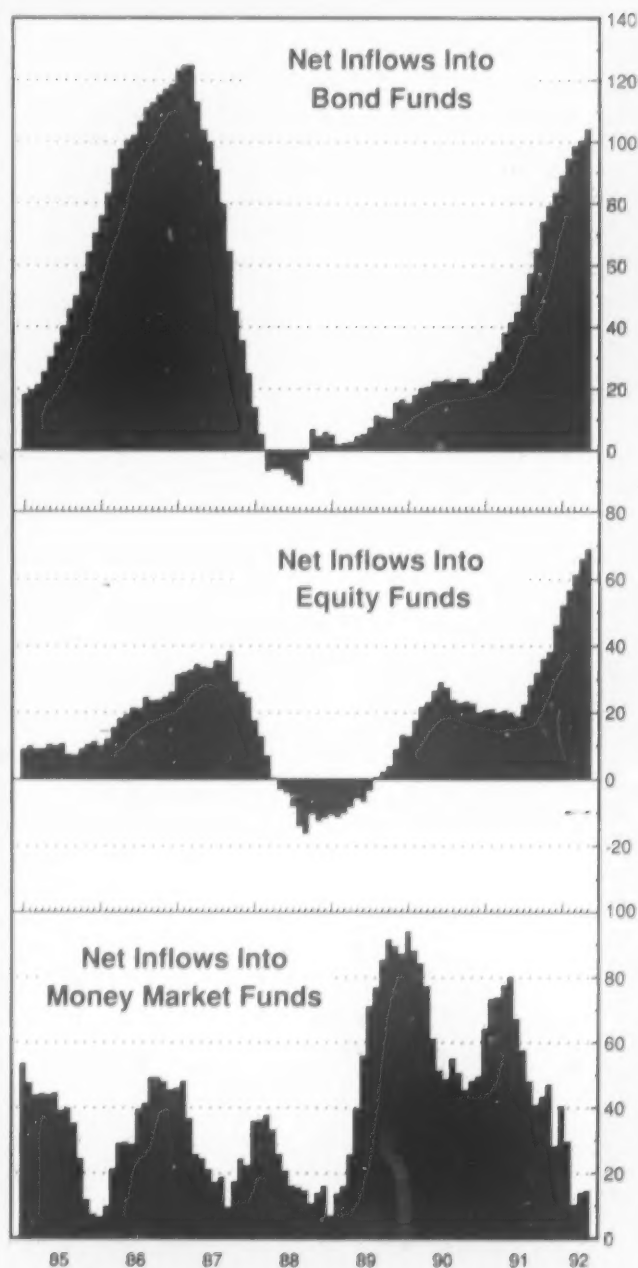
Net Flows Into Mutual Funds

\$ billions, 12-month moving sums, including reinvested dividends



Mutual Funds Inflows Surge

The mutual fund industry is having a banner year, with the total dollar inflow climbing rapidly toward an all-time high. A prime force behind this surge is the recession-related drop in short-term interest rates, which at this level (in contrast to the rates offered a few years ago) leave savers less than satisfied with the rates now being paid on many bank accounts, where most of the money is coming from. Correspondingly, the bulk of the money is targeted for bond and equity funds, rather than the money market funds where the inflows have slowed sharply. Currently, the flow into equity funds is almost twice as large as the previous record in 1987.

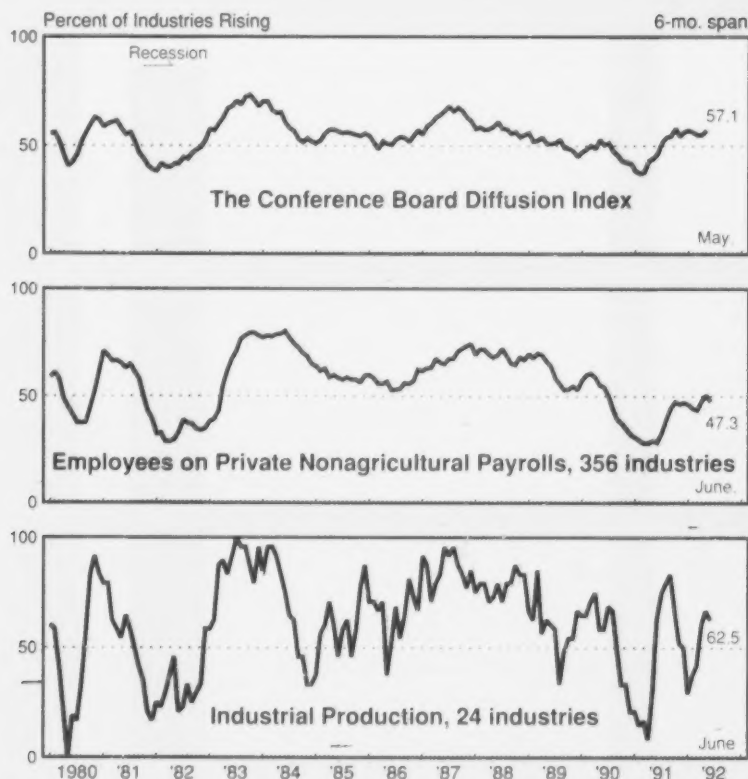


Source: Investment Company Institute

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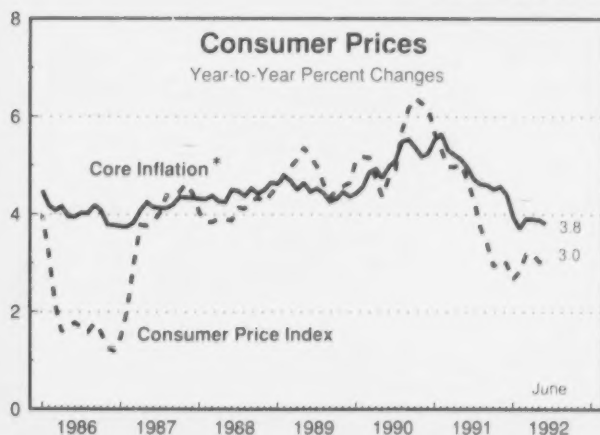
Indexes of Economic Momentum

Economy is developing a modest momentum.

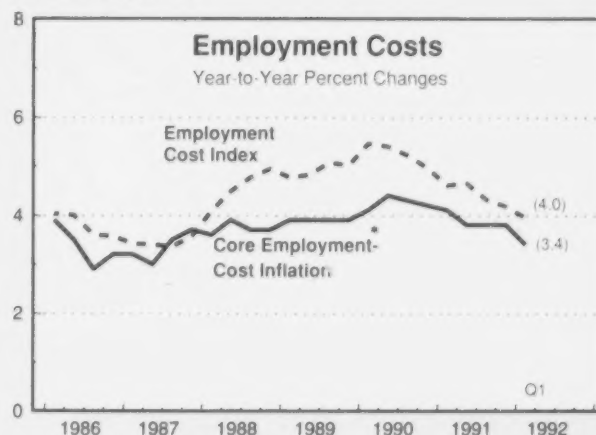


Inflation well behaved.

Inflation Fundamentals



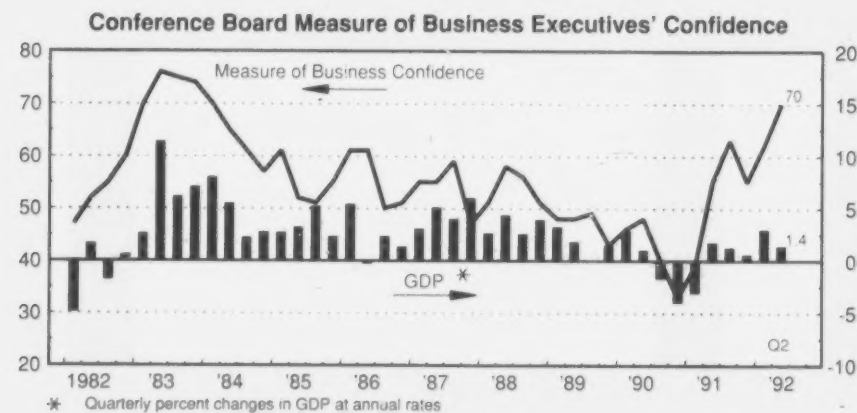
* Core Inflation = CPI excluding food at home and energy.



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

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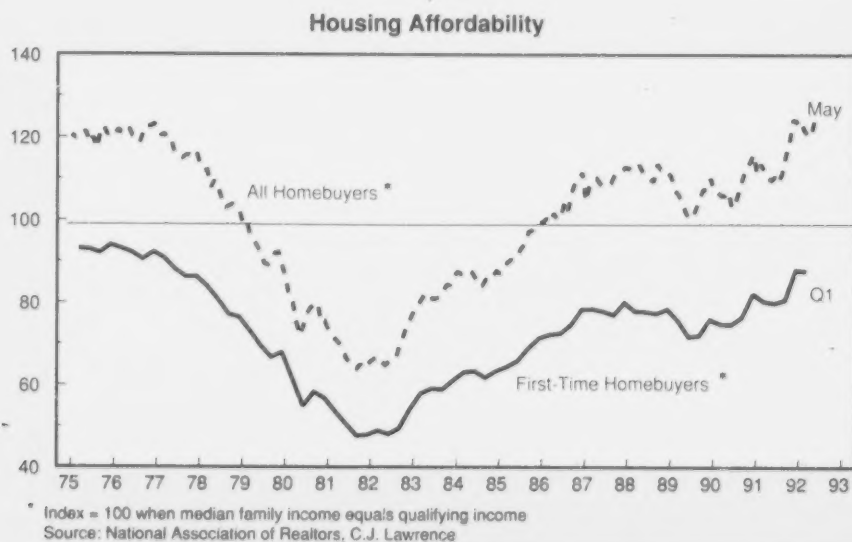
Confidence



Consumer expectations dip again.
Executives quite bullish.

Chart of the Month-II

As Ed Yardini and Debbie Johnson of C.J. Lawrence observed in the July 20, 1992 issue of their weekly Economic Briefing, "Housing affordability is very high, but so is job insecurity."



Inside the Crystal Ball

	UCLA	MERRILL L.	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN - RSQE
Date of Forecast	July	July	July	July	July	July	July	July	July	July	May

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%		
Actual	1991 4Q	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	4Q 1991	Actual
	1992 1Q	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	1Q 1992	
Forecast	2Q	2.1	1.8	2.8	1.2	2.5	2.0	2.1	2.4	2.2	2.5	2Q	Forecast
	3Q	2.3	1.5	3.1	1.6	3.1	2.1	3.4	2.8	3.6	2.6	3Q	
	4Q	2.6	2.8	3.2	2.9	3.0	1.2	3.1	2.8	2.6	2.8	4Q	
	1993 1Q	3.8	3.0	3.6	2.7	3.0	1.5	3.6	3.0	2.9	3.3	1Q 1993	
	2Q	4.3	3.1	3.9	2.9	3.3	3.0	4.8	3.0	2.7	3.2	2Q	
	3Q	3.3	3.0	3.7	3.2	3.0	2.5	3.3	3.1	3.0	2.9	3Q	
	4Q	3.3	2.6	3.5	2.6	2.7	2.2	2.6	2.9	2.9	3.0	4Q	
	1994 1Q	2.8		3.4			1.9		3.0	3.3	3.0	1Q 1994	
	2Q	2.5		3.3			2.2		2.9	3.1	2.7	2Q	

Inflation (Deflator)

(Percent change from same quarter one year earlier)

		%	%	%	%	%	%	%	%	%	%		
Actual	1991 4Q	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	4Q 1991	Actual
Forecast	1992 4Q	3.2	2.8	3.4	2.9	3.1	3.1	2.4	2.8	2.8	3.3	4Q 1992	Forecast
	1993 4Q	3.3	3.0	3.6	3.4	3.3	2.5	2.5	2.9	2.9	2.4	4Q 1993	

30-Yr Treasury Bond Rate

(Percent, quarterly)

		%	%	%	%	%	%	%	%	%	%		
Actual	1991 4Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	4Q 1991	Actual
	1992 1Q	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	1Q 1992	
Forecast	2Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	2Q	Forecast
	3Q	8.1	7.5	7.5	7.7	7.5	7.8	7.7	7.7	7.8	7.5	3Q	
	4Q	8.2	7.5	7.5	7.9	7.5	7.8	7.7	7.6	7.8	7.5	4Q	
	1993 1Q	8.4	7.7	7.6	8.1	7.5	7.8	7.8	7.6	7.9	7.6	1Q 1993	
	2Q	8.4	7.9	7.7	8.2	7.5	8.2	7.8	7.6	7.9	7.7	2Q	
	3Q	8.2	8.0	7.8	8.3	7.5	8.2	7.8	7.5	8.1	7.8	3Q	
	4Q	8.1	8.1	7.9	8.3	7.5	8.2	7.8	7.4	8.1	7.9	4Q	
	1994 1Q	8.0		8.0		7.6	8.2		7.2	8.2	8.0	1Q 1994	
	2Q	7.9		8.0			8.3		7.1	8.2	8.1	2Q	

Unemployment Rate

(Percent, quarterly)

		%	%	%	%	%	%	%	%	%	%		
Actual	1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	4Q 1991	Actual
Forecast	1992 4Q	7.1	7.5	7.4	7.6	7.1	7.6	7.3	7.0	7.1	7.4	4Q 1992	Forecast
	1993 4Q	6.2	6.5	6.6	6.9	6.7	7.2	6.6	6.2	6.5	6.7	4Q 1993	
	1994 1Q	6.0		6.4			7.1		6.1	6.3	6.5	1Q 1994	



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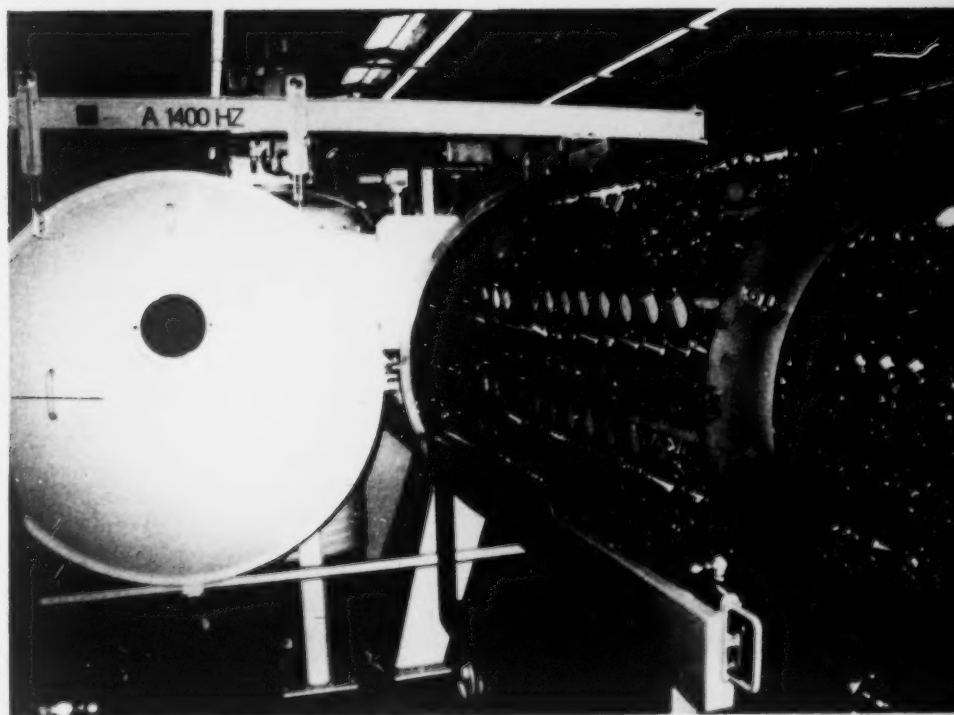


The Conference Board

Volume 3, Number 8

September 1992

Economic Times



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Editor's Note

This month's collection of information covers a broad cross-section of topics at issue in the election: the fairness issue, our health care system, Federal Reserve policy and the role of government. And, of course, the past and prospective performance of the economy, as reviewed in our Stat File and Crystal Ball.

The cover photo, which comes to us courtesy of The Stanley Works, shows the company's new sputter-coating process, an improved way of finishing tape rule cases, replacing chrome plating.

If you haven't already done so, we hope you will answer the few questions in our readership survey on the back of the wrapper this publication arrived in, and send it back to us. Many thanks.

Ed Fiedler

Maxim of the Month:

When we remember we are all mad, the mysteries disappear and life stands explained.

Mark Twain

Dollar Disaster?

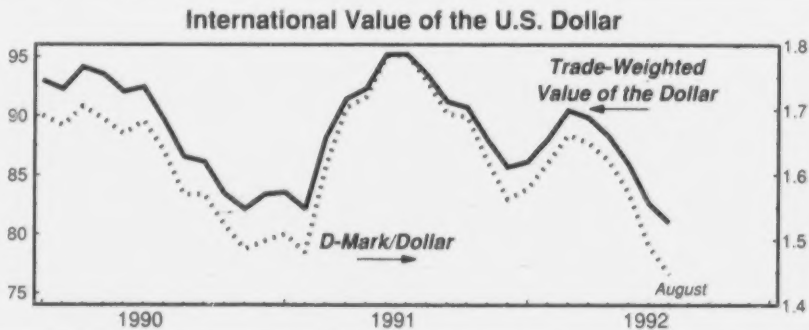
The recent sharp decline of the dollar against the German mark has been reported in apocalyptic terms. Securities analysts blame it for a big one-day sell-off in stocks and bonds, out of fear that the Fed will raise interest rates. A Wall Street economist labels it a crisis of confidence. A newsweekly lamented the high prices Americans are paying abroad. A business magazine spoke of a lot of losers, particularly European companies that export to the United States or compete with U.S. producers in world markets. Others noted that a falling dollar puts upward pressure on imported goods prices and thus adds to inflation. A major newspaper said the drop in the dollar threatens the U.S. economic recovery. And a senior network news anchor suggested that the dollar decline would lead the economy into a depression. The black crepe was everywhere.

Is any of this true? Well, the depression surely not, and the threat to recovery seems awfully remote. Also, focusing only on the dollar/D-mark rate overstates the dollar's decline: on a trade-weighted basis, the August decline is somewhat more moderate (see chart). But the rest of it is technically valid. A declining dollar does create uncertainty, does hurt foreign exporters and American tourists abroad, and does put up the prices of U.S. imports.

But that's only half the story. For every foreign exporter with disappearing profits there is an American exporter who's laughing all the way to the bank. For every American student abroad struggling to make ends meet, there's a foreign student in America who never had it so good. And for every upward price pressure here, there's a downward price pressure abroad.

The central point is that the economy-wide impact of currency changes is mixed. They are a two-way street, with the favorable effects substantially offsetting the unhappy consequences. The one exception is the uncertainty, but living with fluctuating exchange rates is not grossly different from living with fluctuations in the price of oil or any other important international commodity.

But the good-bad mix of effects that tend to balance out is not the message we get from the media. In the news reports the favorable effects are rarely mentioned, while the unhappy consequences are trumpeted at top decibel. There is nothing surprising about this, of course; as the journalist Edgar Watson Howe observed decades ago, "Except the Flood, nothing was ever as bad as reported." Furthermore, there's not much to do about it, except to remember that, like Mark Twain, reports of our economic death are greatly exaggerated.



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Editor: Edgar R. Fiedler

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Colloquium: How Much Government?

BACKGROUND

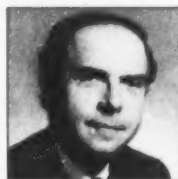
A controversial issue in the current Presidential campaign (although not often stated just this way), is the extent to which the federal government should involve itself in "the private sector." Almost all economists agree (a) that government should set rules on such matters as property rights and contracts, and (b) that it should carry out broad fiscal and monetary policies, but (c) that it should stop its participation far short of U.S.S.R.-type socialism. That still leaves plenty of room for disagreement about how much regulation, subsidies, lending programs, import and export controls, and even government ownership of certain industries, is appropriate.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Gail D. Fosler, Vice President and Chief Economist, The Conference Board; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

QUESTION

How Far Do We Go? How Much Government Involvement Is Appropriate For The U.S. Economy? How Do We Decide Where To Draw The Line?



Robert G. Dederick
Northern Trust Company

If only Washington could be counted on to do the right thing. Any microeconomics textbook could then tell us where and to what extent government should interfere. But Washington *can't* do better! Too few able decision-makers with too many conflicting interests live there. The result might well be politically satisfactory in the short run, but it's often economically disastrous in the longer term—which sometimes can come quickly. Ask any taxpayer who has been bailing out the savings and loan system. (Now, what was that question?)



Charles E. Walker
Charles E. Walker Associates

The general principle: Government "intrusion" should be limited to mitigating market imperfections. But even where markets perform efficiently, intrusion may well be justified in order to "tilt" society away from consumption and toward policies in education, technology, and national saving and investment that assure productive capital formation and future growth. An industrial "strategy" is both warranted and needed. An industrial "policy" that picks specific winners and losers among industries *is not*.



Laura D'Andrea Tyson
University of California, Berkeley

The United States should look to the other advanced industrial countries, where the government's role is consistently more extensive and varied than it is here. Foreign governments provide substantial funding and leadership for national health care, education and training, and the social safety net. Their investment in public infrastructure already dwarfs ours, and the gap is growing. Most of these countries are now doing as well as we are economically, and their social problems are much less severe than ours. It's time to follow their example.



Stephen H. Axilrod
Nikko Securities International

We should go far enough to keep the fabric of our society well-knit. The market is not always right, nor sometimes much concerned, so government involvement will vary over time (though in general less is better than more). For now, to give a few examples, the government should provide incentives for private and public investment, encourage higher educational standards, and keep a more efficient social safety net intact. Eventually, enough taxes should be collected to do the job.

Rich and Poor— Sorting Out the Fairness Question

by Isabel V. Sawhill and Mark Condon



It is widely believed that U.S. incomes have become more unequal since the early 1970s. Liberal politicians cite this as evidence that American society is becoming more stratified, that the rich are getting richer and the poor poorer. Conservatives respond that these analyses are flawed—arguing that they fail to recognize the tremendous individual mobility hidden within the averages.

Here we seek to clarify the debate by looking at data on a sample of individuals whose incomes were tracked between 1967 and 1986. Based on our analysis to date, the story is as follows:

- If we rank all the jobs or other income-producing opportunities in society from highest to lowest, we find a growing gap between the top and the bottom. The rewards for success or good fortune have gotten larger and the penalties for failure or bad luck have grown correspondingly.
- When society's reward structure is highly unequal it puts a big premium on individual income mobility. As long as there is a lot of mobility, an unequal reward structure is not necessarily a problem. If there is little mobility, then it is. Individual mobility in the United States falls somewhere between "a lot" and "a little." Many people do move from one income stratum to another. When one follows individuals rather than income groups, one finds that, on average, the rich got a little richer and

the poor got much richer over both the decades for which we have data.

- Lifetime incomes may still be getting more unequal, however. If the reward structure is getting more unequal, lifetime incomes are going to be more unequal unless growing wage inequality is offset by more mobility between jobs or other income-earning opportunities. We find no evidence that individual mobility increased between the 1970s and the 1980s.

Thinking about Fairness

Joseph Schumpeter, a famous economic historian, once likened the distribution of income to rooms in a hotel—always full, but with different people. In a hotel in which all the rooms are alike it doesn't matter which one you occupy. But in most hotels, as in most societies, some rooms are exceedingly luxurious, others are quite shabby, and which room you end up in matters a lot. Fairness requires that you have an opportunity to change rooms.

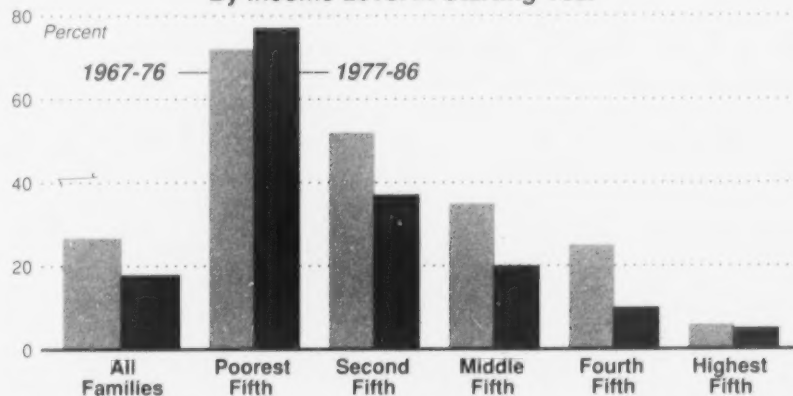
To measure inequality by the usual method, the U.S. Census Bureau and other statisticians look at the hotel registry each year to see how many people are occupying each type of room. All

families are ranked by their annual incomes from highest to lowest and sorted into five groups, called quintiles. Then, to test whether economic inequality has risen, the average income of each quintile in one year will be compared to the average income of that same quintile in another year, *even though each quintile may now contain a different set of individuals.*

The data suggest that after growing between 1967 and 1976, the average income of the bottom quintile declined between 1977 and 1986. In both periods, the average income of the top quintile grew rapidly. These are the kinds of calculations that have been used to conclude that "the rich are getting richer and the poor poorer" over the last decade or two.

What has caused this growth in income inequality as conventionally measured? Most analyses have shown that the main cause is the growing inequality of earnings. Although the tax system is a little less progressive than it was in the past and the safety net somewhat frayed, these changes have not been as important as the increasing gap between the

**Increases in Real Family Incomes
By Income Level in Starting Year**



Source: Urban Institute

Note: Sample limited to adults ages 25 to 54 in starting year

wages of higher-paid and lower-paid workers.

This less equal distribution of earnings, in turn, appears to be related to technological changes and international competition, which have put a high premium on education and experience. The rewards for both have been increasing since the late 1970s. And unless income mobility increases to offset these structural changes in the economy, lifetime earnings may become increasingly unequal.

People Swap Rooms Often

We now turn to a different set of data, which track the earnings of individuals (adults, ages 25-54 in the starting year) from year to year across the decades. These data show that individual mobility in the United States is substantial. In the decades 1967-76 and 1977-86, some three out of five adults changed income quintiles. A little less than half the members of the bottom quintile moved up into a higher quintile, and about half the members of the top quintile fell out of that quintile. In both periods, more than two-thirds of those who started out in the middle quintile had moved up or down into a different quintile by the end of the period.

If mobility between income classes is a glass that is half full, it is also half empty. A little more than half the occupants of the bottom quintile had not risen out of that quintile ten years later, and half of the occupants of the top quintile remained there ten years later.

Nonetheless, as the chart shows, the mobility that did occur ensured that over both decades, on average, the poor (here defined as those in the bottom quintile at the beginning of each decade) grew much richer, by 72-77 percent. The rich (defined as those in the top quintile at the beginning of the decade) grew a little richer, by 5-6 percent.

These figures will not surprise the experts. Any significant mobility should lead to the same pattern. People who start at the bottom have nowhere to move but up, and are likely to do so as they become older, gain work seniority, and earn higher incomes. People who start at the top, some of whom may be there because of temporary sources of income like capital gains, have nowhere to go but down.

This pattern, however, may be surprising to the general public, which has been led to believe that the poor were literally getting poorer over the last dec-

ade or two, and that the incomes of the rich were skyrocketing. This is simply not true.

A Room of One's Own Is Not Necessarily a Room With a View

While many individuals swap rooms over time, our data show that the degree of mobility in the U.S. economy has not increased. Although the poor can "make it" in America, and the wealthy can plummet from their perches, these events are no more likely to occur today than in the 1970s. What has changed is the rooms.

Specifically, the rooms at the top have an increasingly nice view, while the ones at the bottom have deteriorated. Indeed, some will conclude that the hotel we call the U.S. economy has become a more class-stratified place to live. Others will argue that the lure of a better view is what induces people to try to change rooms in the first place.

Whether the notion of class is half full or half empty depends on your perspective.

Excerpted from *Policy Bites*, June 1992. Isabel Sawhill is a senior fellow and Mark Condon is a former research assistant at The Urban Institute.

Quotable Quote

Stephen S. Roach on California Aftershocks



The 1990s have come as a rude awakening for the once proud Golden State. Indeed, the economic climate in California continues to deteriorate. The state's unemployment rate rose to 9.8 percent in August, more than two points above the national average.

The California economy is now being hit with a "triple whammy." First, the downsizing of the defense industry is having an unmistakably sharp impact there. A second factor hitting California is the ongoing pressures of service sector restructuring; the shake-out in services is particularly painful for a State whose service sector unemployment share is fully 3.5 percentage points above the national average. Third, the recent collapse of the housing market has taken a particularly sharp toll on California consumers—many of whom had long grown accustomed to financing personal spending by tapping the rapidly expanding equity of their personal housing portfolio.

For California, the triple whammy will not fade overnight. These are structural developments that can be expected to play out over several years. To be sure, economic conditions vary widely across the state, and a case can be made that Northern California will probably do better than the South. Be that as it may, the overall economic climate for California in the 1990s looks radically different today than it did in decades past. And with this state now accounting for over 13 percent of total personal income in the United States, tough times in California sound a clear note of caution for the long-awaited recovery in the national economy.

Adapted from "Inside the U.S. Economy," July 17, 1992. Stephen S. Roach is Senior Economist at Morgan Stanley & Co.

The Best Health Care System in the World?

by Victor R. Fuchs



Does the United States have the best health care system in the world, as some claim? Or does the answer to that question depend on the criteria used? The "best" health care system may be like the "best" spouse—it all depends on what one is looking for.

The economic point of view suggests assessing three dimensions of the "output" of health care: technologic, public health, and service, and then considering each of these from the perspectives of efficiency and distributional equity.

Technology. One way to evaluate health care systems is to ask in which country do we find the most advanced medical technologies in the greatest abundance? Where do the world's most ambitious young physicians go for advanced training? And where do the super-rich from Third World countries go when they want high-tech medical care? The answer to all these questions is usually the United States. In this sense we can accurately say that the United States has the best health care system in the world. New drugs are an exception; the Food and Drug Administration's lengthy review may result in prior introduction abroad, even if drugs were developed by U.S. companies.

Public Health. Another way of judging the merits of a health care system is by the health of the population. This could be based on simple measures, such as life expectancy, or on more complex ones that take into account quality

of life as indicated by the absence of morbidity or disability. From this perspective the United States ranks below average among economically developed countries according to most measures. For example, life expectancy at birth is 4.5 years less in the United States than in Japan (1988).

Service. Health care has always meant more than improving health outcomes. Particularly important are the caring function (sympathy and reassur-



ance) and the validation function (provision of professional certification of health status). Until this century the service, caring, and validation offered by health professionals were undoubtedly more valuable than their therapeutic

interventions. Even today most disease is either self-limiting or incurable, but people who are sick or in pain want access to physicians, nurses, and other health professionals.

Thus an important criterion for evaluating a health care system is the availability of services. Is it easy to get to see a physician? Or to reach one by telephone? How long does a bedridden hospital patient lie in urine before someone responds to a call? Do health aides regularly visit the homebound elderly? Are dying patients treated with compassion? Very little data are available concerning this perspective, but countries probably differ considerably in the quantity of services provided. Germany, for instance, provides more than twice as many physician contacts and hospital days per capita as the United States, but there are many dimensions of service that are unmeasured.

Efficiency. A country can rank high with respect to technology, to the public's health, and to the provision of services, but if it can do so only by making extraordinary claims on the country's resources it would rank low from an efficiency perspective. Much of the criticism of the U.S. health care system arises because Americans spend 40 percent more than Canadians for health care, and the excess over European countries is even greater. England's parsimonious use of resources is particularly noteworthy. Although high-tech medicine is severely rationed, England's level of public health is about the same as America's, and it manages to provide a considerable amount of service while spending only \$1 per capita for every \$3 spent in the United States.

Distributional equity. Another perspective examines the distributional equity of the health care system. All else

held constant, many people believe that a more equal system is a better system. Consider, for instance, a country which has an average life expectancy of 76 years, but which also has great inequality. Some of its citizens die in childhood or as young adults, while others live past 90 years of age. Given any reasonable assumption about risk aversion, most people would prefer to be born in a country in which everyone lives to age 75. Similar arguments can be made about the distribution of technology or

of service. The fact that most countries provide universal health insurance while one in seven Americans is uninsured denies the United States a favorable ranking from this perspective.

Conclusion. Let us return to the original question. Does the United States have the best health care system in the world? It does technologically, but not from any of the other four perspectives. In particular, we need to improve efficiency (control the high cost of care) and distributional equity (provide uni-

versal insurance). The public health and service dimensions also need closer scrutiny. If and when we progress in those areas, claims of superiority for American health will be more convincing.

Excerpted from *The Journal of the American Medical Association*, v. 268:916-917, August 19, 1992, © Copyright 1992, American Medical Association. Victor R. Fuchs is Henry J. Kaiser, Jr. Professor, Stanford University, and Research Associate, National Bureau of Economic Research.

Price Stability Should Be The Fed's Paramount Goal

by Gary H. Stern



The most interesting and fundamental issue in central banking today is the argument that price stability should be the paramount objective of monetary policy. That conclusion rests on three main propositions: First, that the goal of economic policy is to achieve sustained prosperity. Second, that the principal contribution monetary policy can make to that goal is to establish price stability, since our economy does not work well in an inflationary environment. And third, that inflation is ultimately a monetary phenomenon.

The debate centers on the second proposition. Some maintain that the benefits of price stability are small and that most of them can be obtained by suitable indexing of taxes, compensation, and credit agreements. This position is seriously flawed, however, because comprehensive indexing is unlikely and at most would be a

second-best substitute for price stability.

A more serious intellectual challenge is posed by those who assert that the goal should be a stable inflation rate rather than price stability. The historical record argues against this position in two ways: First, for whatever reasons, countries that abandon price stability as a goal generally experience accelerating inflation, not a stable inflation rate. Second, comparisons across countries show that over the long term lower inflation rates are associated with stronger growth.

Some worry that too rigid a commitment to price stability could prevent the Federal Reserve from responding appropriately to "shocks," such as a sharp break in stock prices or other threats to the financial system. Not so—even large injections of liquidity are compatible with price stability if they are temporary.

A more substantial concern is the fear that the short-term pursuit of price stability will lead to losses of employment and output, as suggested by the Phillips curve. If, however, the credibility of the Federal Reserve's commitment to price stability and its ability to attain the goal are high, expectations about wages, prices, and interest rates are likely to moderate quickly. For example, when the Fed some months ago reaffirmed its commitment to price stability, financial markets responded promptly and favorably. If the Fed's policies are credible, price stability can be attained at acceptably low cost.

But credibility has to be earned, and that may be a slow and frustrating process. It requires that the Fed stick to its guns at times when there are pressures to stray—such as pressures to adopt expansionary policies to temporarily boost the economy.

Moreover, the Federal Reserve is limited in its ability to pursue expansionary policies, even if it so desired. A country that pursues a more expansionary monetary policy than its trading partners is likely to see its currency decline in value. This accelerates inflation and results in an unsustainable situation. Now that more and more central banks are explicitly committing themselves to price stability, the range of options for any one country is narrowing.

In summary, I believe that price stability remains a worthy policy goal, even though it is proving a challenge to obtain. We need to be patient, however, and we will be rewarded if we are. The health of our economy will best be restored in a noninflationary environment.

Adapted from a presentation to the National Economists Club, Washington D.C., September 1991. Gary H. Stern is President of the Federal Reserve Bank of Minneapolis.

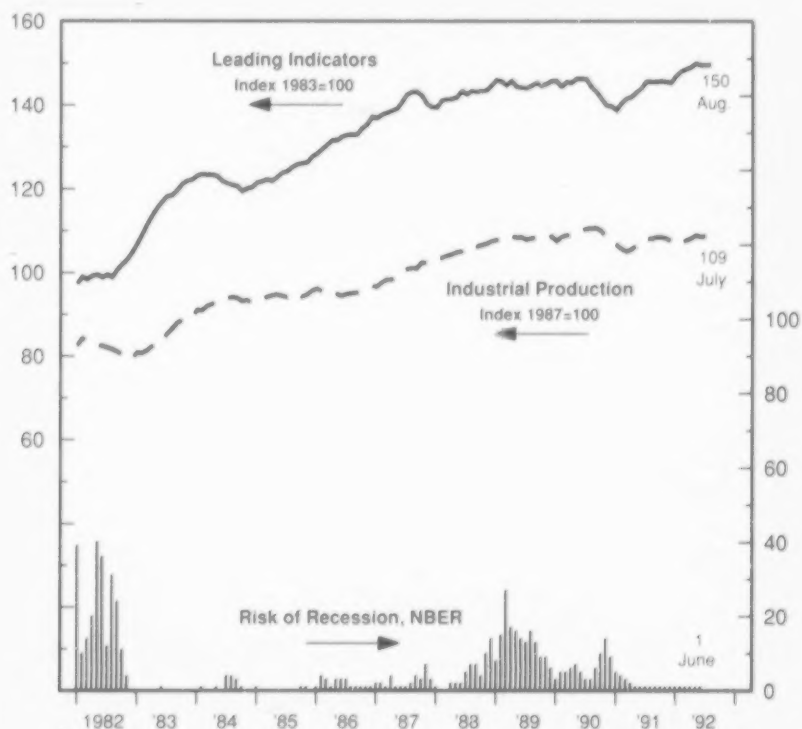
Conference Board Stat File

The Four Ds

Little has changed in recent months. The one uncontested piece of good news is the continuing gradual deceleration of inflation (p. 9). The outlook for economic activity is also favorable in that all the forecasters on our Crystal Ball page project rising real GDP through 1993. But that's about as far as the optimism can be stretched. To date the pace of advance remains as limp as before, too slow to create (net) new jobs. The constraining forces are what Ed Campbell of Brown Brothers Harriman has labeled "the four Ds:" The DEBT overhang, which inhibits new investment; chronic massive budget DEFICITS, which raise real long term interest rates; DEMOGRAPHICS, that is, the slow pace of household formation, which limits demand for housing and related big-ticket consumer goods; and DEFENSE spending, which is being reduced steadily. As long as these impediments to expansion remain in place and consumers stay a bit melancholy (p. 10), the odds are heavily against an appreciably stronger economy. (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

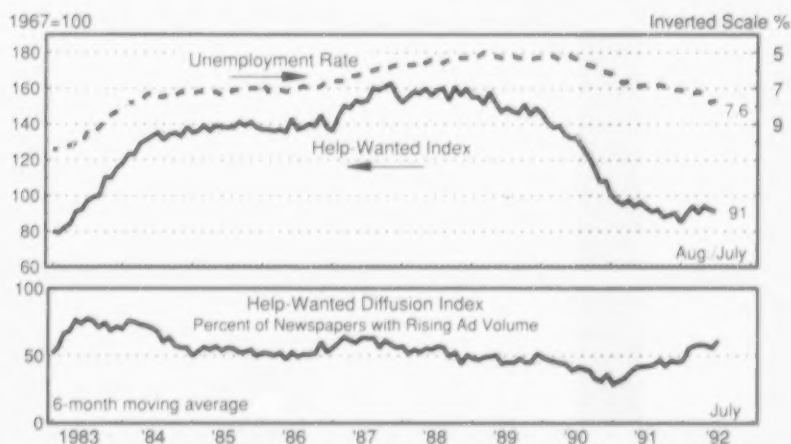
Early Warning Indicators

Still pointing to sluggish growth.



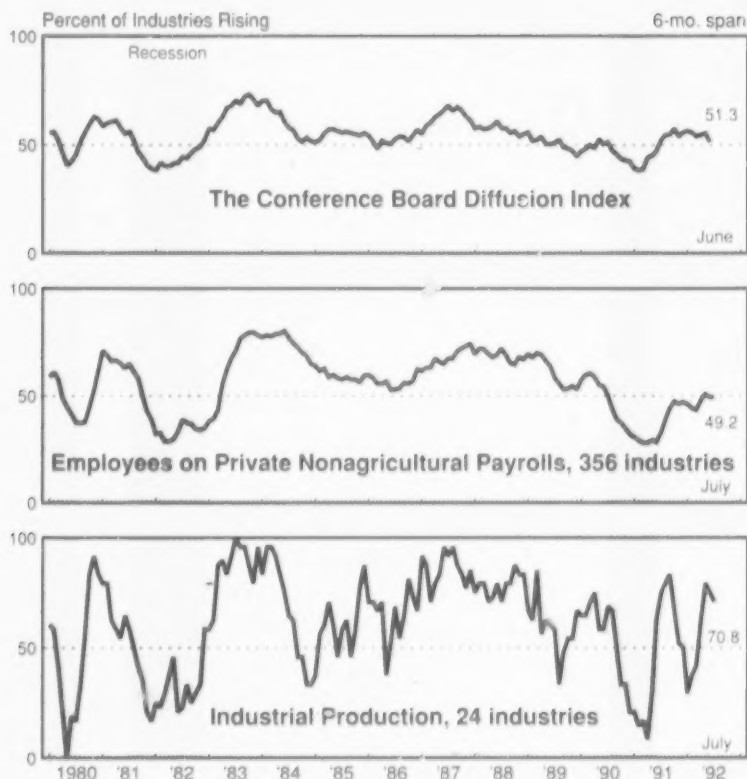
Help-Wanted Advertising and Unemployment

Labor markets remain soggy.



Conference Board Stat File

Indexes of Economic Momentum



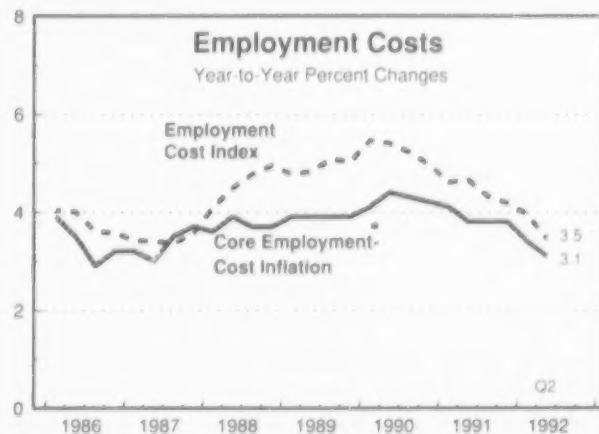
Momentum found only in the industrial sector.

Core inflation below 4 percent.

Inflation Fundamentals



* Core Inflation = CPI excluding food at home and energy.



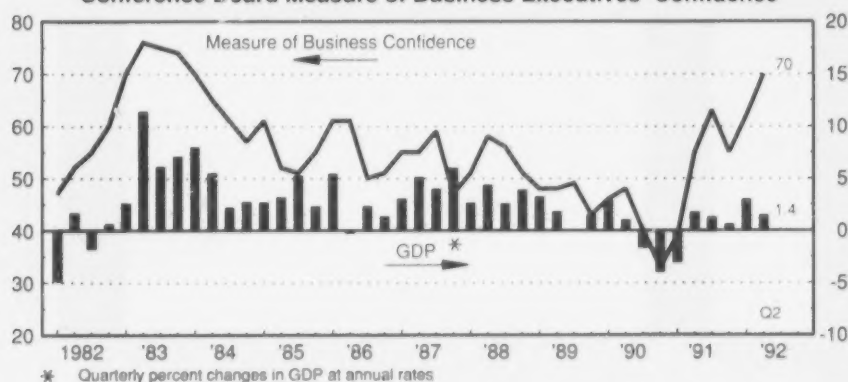
* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

Confidence



Conference Board Measure of Business Executives' Confidence

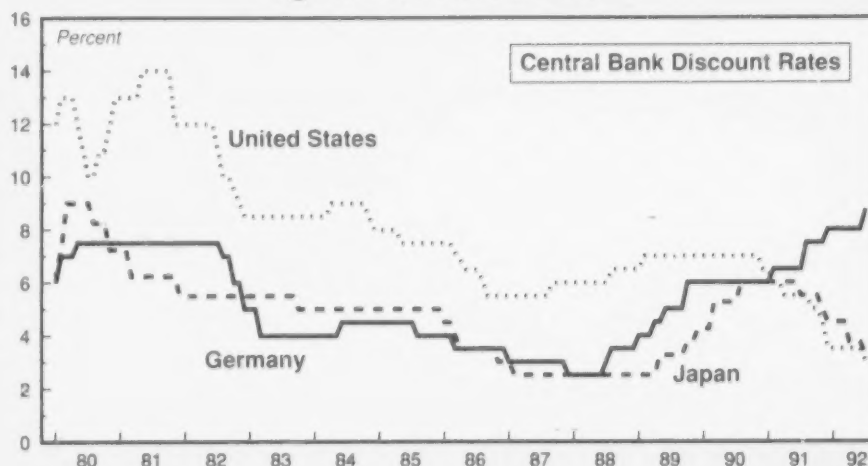


Major differences persist between consumers and executives.

Chart of the Month

The most sensational story in the financial markets this month was the rise of the D-mark against the dollar. The main reason for that currency swing is the enormous gap that has opened between short-term interest rates in Germany and the United States—an extraordinary 5.75 percentage points in the central bank discount rates.

Big Three Interest Rates



Inside the Crystal Ball

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Date of Forecast Aug. Aug. Aug. Aug. Aug. Aug. Aug. Aug. Aug. Aug. Aug.

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	%		
Actual	1992 1Q	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	1Q 1992	Actual
	2Q	1.4	1.4	1.4	1.6	1.4	1.4	1.4	1.4	1.4	1.4	1.4	2Q	
Forecast	3Q	2.0	1.5	2.6	1.8	2.8	1.2	2.2	1.9	1.8	2.5	1.3	3Q	Forecast
	4Q	2.0	2.8	2.9	3.0	3.0	1.3	3.1	2.4	2.9	2.9	3.1	4Q	
	1993 1Q	3.2	2.9	3.3	2.9	3.1	1.5	4.0	3.2	3.3	3.2	3.9	1Q 1993	
	2Q	3.7	3.0	3.8	2.7	3.3	2.9	3.9	3.1	3.7	3.0	3.6	2Q	
	3Q	3.4	2.2	3.8	3.6	3.0	2.3	3.5	3.2	3.5	3.9	3.1	3Q	
	4Q	3.3	3.4	3.7	1.3	2.7	2.1	2.4	2.8	3.7	2.9	2.6	4Q	
	1994 1Q	2.8		3.7			1.6		3.0	3.2	3.2	2.7	1Q 1994	
	2Q	2.6		3.6			1.9		3.0	2.6	2.4	2.6	2Q	
	3Q			3.6			2.0		2.9	1.8	2.7	2.4	3Q	

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Actual	1991 4Q	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	1991 4Q	Actual
Forecast	1992 4Q	3.8	3.6	3.8	3.5	3.7	4.0	3.5	3.5	3.2	3.6	3.2	1992 4Q	Forecast
	1993 4Q	3.1	2.9	3.3	3.4	3.0	3.2	3.0	2.2	2.9	3.1	2.4	1993 4Q	

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual	1992 1Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	1Q 1992	Actual
	2Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	2Q	
Forecast	3Q	7.6	7.5	7.5	7.8	7.5	7.4	7.5	7.5	7.5	7.5	7.5	3Q	Forecast
	4Q	7.7	7.5	7.5	7.9	7.5	7.5	7.1	7.3	7.5	7.6	7.4	4Q	
	1993 1Q	7.9	7.7	7.6	8.1	7.5	7.5	7.1	7.2	7.7	7.7	7.4	1Q 1993	
	2Q	7.9	7.9	7.7	8.2	7.5	7.8	7.2	7.1	7.9	7.8	7.4	2Q	
	3Q	7.7	8.0	7.8	8.3	7.5	7.9	7.2	7.0	7.9	7.9	7.4	3Q	
	4Q	7.6	8.1	7.9	8.3	7.5	8.0	7.2	6.9	7.8	8.0	7.3	4Q	
	1994 1Q	7.5		8.0		7.6	8.0		6.8	7.9	8.1	7.2	1Q 1994	
	2Q	7.4		8.0		7.6	8.0		6.7	8.0	8.1	7.2	2Q	
	3Q			8.0			8.0		6.5	7.9	8.2	7.2	3Q	

Unemployment Rate

(Percent, quarterly)

Actual	1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	4Q 1991	Actual
Forecast	1992 4Q	7.6	7.4	7.4	7.4	7.3	7.8	7.6	7.7	7.6	7.7	7.6	4Q 1992	Forecast
	1993 4Q	6.7	6.5	6.6	6.7	6.9	7.8	7.0	6.8	6.7	6.9	7.0	4Q 1993	
	1994 3Q			6.0			7.7		6.2	6.1	6.4	6.8	1Q 1994	



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Economic Times



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Editor's Note

Another three months have rolled by, so it's time again for our regular quarterly review of the outlook for major industries, which you will find in the center (colored) section of this issue. In addition, we offer an article on the increased mobility of capital, a little appreciated development that has broad implications for some of the theoretical foundations of economic analysis. This article, incidentally, builds on some of the ideas developed by Alan Greenspan in his piece on product downsizing that was excerpted in the September 1991 *Economic Times*.

We also have an update on the painful transition being made by the Polish economy to a market system. Our faithful Colloquium panel takes a look at one important aspect of the recent financial turmoil in Europe. And of course, our regular Stat File and Crystal Ball features on the economic outlook are included.

Our cover illustration this month comes to us courtesy of AT&T. It shows a Bell Labs researcher demonstrating a laser that could be applied to switching and computing technology. Finally, note that our maxim of the month was selected with the forthcoming elections in mind.

Ed Fiedler

Maxim of the Month:

**You can't learn too soon
that the most useful thing
about a principle is that it
can always be sacrificed to
expediency.**

W. Somerset Maugham

Cruelty and Anger

Any friends who ask me about politics these days usually don't get an answer. If they persist, they might get a snarl and a mumbled cliché such as "a plague on both their houses" or "we need less politics and less government, not more."

My reluctance even to comment on politics has been overcome, however, by a recent outrageous example of too much politics/government: a *New York Times* story about the Gowanda (NY) Psychiatric Center. In a massive facility that once held 3,710 patients, the state now cares for just 14 with a staff of 44 psychiatrists, therapists, admissions officers and others, at a cost of about \$200,000 per patient per year. The politics that is perpetuating this insanity is the pressure being exerted on the state legislature by community leaders, local lawmakers and unions to preserve the jobs at the facility, and the unwillingness of the legislature to override that pressure.

Some of my friends will dismiss Gowanda as a bizarre aberration unrepresentative of most government activities. Not so, in my view. Although I readily agree that this is an egregious example, I'm afraid it's all too representative. Consider the postal service, public schools, the police, welfare, toxic waste disposal, farm subsidies, student loans, public housing, import quotas, and cable TV regulation: almost every item on that list will, I'm sure, bring to mind instances of fraud, venality, inefficiency, waste, or mismanagement created by government.

Does government always fail? Certainly not. Sometimes it functions rather well. Meat inspection seems to work effectively, for example. Some public schools

are very proficient. I've always regarded the Census Bureau as a "good bureaucracy;" the IRS, too (with qualifications). But those are not the general rule; too often, government is ineffective and harmful rather than helpful.

Does the private sector always do things right? No, indeed. But when the endeavors of individuals and private institutions get messed up, as happens frequently enough, the damage that's done is more often limited in size, confined to the parties directly involved, and cut off sooner than with public activities—not always but more often.

The reason I'm down on politics, then, is not that the private sector is free of failure, but because the costs of failure are substantially greater in public activities. The essential reason for this, I believe, is the way our political system creates incentives not to serve the public but rather to preserve the jobs of politicians and bureaucrats, and thus to push the system still further in the direction of bigger and less productive government.

If, however, all that was involved here was a waste of tax money, this story would not warrant any anger. But it's not just that. The point is that the \$3 million being spent each year to care for 14 patients in Gowanda could otherwise be used for community residences—widely regarded to be a more humane and more effective method of treating most mentally disturbed people—that would take care of more than 100 of the mentally ill who are now living a tormented, painful existence on the streets of our major cities.

Thus, the politics of saving jobs in Gowanda is not just wasteful. It is cruel. And that is worth getting angry about.

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Colloquium: A Single Currency for Europe?

BACKGROUND

Europe's financial markets have been in turmoil recently. First, the British pound and the Italian lira were suspended, and the Spanish peseta devalued, from their previous relationships within the exchange rate mechanism. And then the 51 to 49 margin by which French voters approved the European union (Maastricht) treaty seemed too narrow to portend eventual approval of the union throughout Europe. These events have raised serious doubts that the final monetary goal of the union—a single currency by the end of the century—will be reached.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Gail D. Fosler, Vice President and Chief Economist, The Conference Board; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

QUESTION:

How important is a single currency to Europe? Do the promised gains in efficiency from the union depend upon a common currency and a common monetary policy? Or can most of the benefits be realized simply by removing all barriers and harmonizing all regulations, even though each nation keeps its own currency?



James Tobin
Yale University

The Maastricht agreement mistakenly made a single European currency (ecu) the principal symbol of the "European idea." The ecu is certainly not indispensable for realizing the benefits of a borderless regional economy. And it's premature. The twelve nations are insufficiently compatible in institutions, circumstances and priorities to surrender national monetary independence and freedom to adjust to shocks by movements in exchange rates. Someday, maybe, but not this century.



Gail D. Fosler
The Conference Board

Europe should create a common currency as well as maintain its present national currencies. Even if all regulations and barriers to exchange were eliminated, global competitive pressures would create large differences in economic performance among the countries. A common currency would encourage region-wide trade by eliminating exchange inefficiencies while individual currencies would signal country differences and encourage policy efficiency. The United States does not have such an option to address its regional economic problems.



Isabel Sawhill
The Urban Institute

As long as countries follow different economic policies in pursuit of national goals, exchange rates cannot be kept within narrow bands. This is why the exchange rate mechanism broke down and why we're likely to see a common European currency soon. Yes, many of the same benefits can be achieved by reducing trade barriers, but not all. Imagine what it would be like if U.S. businesses had to worry constantly about the value of the California yin-yen relative to the Florida orangemark.



Lyle E. Gramley
Mortgage Bankers Association

The benefits to economic welfare in Europe associated with a common currency are not trivial, but they pale by comparison with those stemming from complete removal of barriers to trade and finance. Nonetheless, the currency turmoil in Europe these past few weeks is of profound significance, because it indicates a lack of political will—particularly on the part of Germany—to adopt macroeconomic policies that are in the broader interests of all European countries. Can disharmony with regard to trade and financial policies be far behind?

Capital Mobility: Challenges for Business and Government

by Richard B. McKenzie and Dwight R. Lee



One of the most profound changes in American business during the past decade and a half is that it is no longer just American. Neither is Japanese business simply Japanese, nor German business, German. Most lines of business activity are virtually unfettered by geopolitical boundaries.

We submit that democratic capitalism (and socialism) has changed dramatically—and continues to evolve—because capital has gone through a metamorphosis of major proportions. Not too many decades ago, capital was epitomized by steel and concrete, and huge factories. Belching smokestacks were capitalism at its finest. Capital was tied to its physical location: by virtue of its size, it was immobile. This “old capital” was then much like a caterpillar on a large spring leaf, fat and happy, maybe a little sassy.

In the mid-nineteenth century, when capital was growing rapidly in power and size and was so visible and immobile, Karl Marx’s vision should have surprised no one: that workers would rise up, appropriate the capital, and enlarge the state. Capital could not, in the short-run, easily be moved in response to abuse or appropriation. With the industrialization of the capital base continuing through much of this century, it should also have been no surprise that John Kenneth Galbraith would argue with confidence that government should and could become a “countervailing power” against big businesses within the “new industrial state.”

Historically, old capital was very real and tangible, separate and distinct from the owners who managed it and the workers who operated it. This was a circumstance ripe for class conflict, which manifested itself in management-union struggles, as well as in the demagogues’ rhetoric of class conflict.

Similarly, the immobility of capital made governments powers unto themselves. Much like business monopolies, governments did not have to worry much about what other governments were charging in the way of taxes and regulations for the right to operate in their jurisdictions. The presumed monopoly power of governments afforded policymakers the opportunity to try out their fondest designs to reconstruct and improve society from the seats of government power. The rewards to those who benefited from the policies could be immediate while the cost of the programs might be felt by future generations encumbered by the steady, but slow, depreciation and exodus of the country’s capital base. This circumstance allowed government to expand, since politicians could often escape accountability for negative economic results of their programs.



“New Capital”

Factories made of steel and concrete still dot the landscape, but their economic dominance seems more a feature of the underdeveloped, or rather mis-developed, economies of Eastern Europe than of the Western World. The caterpillar has turned into a butterfly; that is, capital has become more like a butterfly—flighty and elusive, much more capable of evading the grip of governments, and the charges they may try to exact.

The “new capital” has become progressively more mobile. Factories have been downsized. Equipment has been miniaturized at the same time it has been made more productive. Consider, for example, the greater amount of capital that has been packed progressively tighter on thumbnail-size computer chips. The decreasing size and the increasing power of capital and the declining cost of transportation have combined to make modern capital far more fugitive, less captive, than it was just a few years ago.

Furthermore, the critical assets of companies are no longer steel or buildings. They are more often than not the information and the brainpower at the companies’ disposal for creating the quintessential company asset—good ideas for doing things better, faster, cheaper, and more profitably at the most favorable location on earth.

Physical location no longer carries the economic value it once did. Business can be, and is, conducted on a global scale, with rapidly decreasing concern and respect for national borders. It is no overstatement to say that quicksilver capital has united, and integrated, the work forces of the world to an extent never imagined by Marx, but with consequences for government power diametrically opposite to the ones Marx

and his followers expected. Geography no longer defines national economies, a fact that has politicians befuddled. The complexity of economic activity, which politicians seek to influence, has been vastly increased.

The critical assets of companies are no longer steel or buildings. They are the information and brainpower that create good ideas.

Government Policies in a Quicksilver World

Leaders of advanced democratic countries have always been concerned about the political consequences of their fiscal and regulatory decisions. After all, they can be turned out of office. However, they now have a new concern, grounded on the economic consequences of the policies they adopt.

Much modern capital is fully capable of moving away from countries that impose unnecessarily onerous policies. This new quicksilver capital has forged a closer linkage between the touted benefits of government policies and their economic consequences.

In effect, greater capital mobility has made governments into competitors, and governments are being constrained by competitive forces in much the same way (although not to the same extent) that businesses are constrained. Elected officials must now fear that if they raise their "tax-prices" or even fail to lower them, or resist improving the quality of their services, then businesses can go to more hospitable jurisdictions, removing the tax base that is the public sector's life blood.

Five Lessons of International Competition

In the 1950s and 1960s many American firms and their workers grew comfortable with their dominant commercial positions in domestic and world mar-

kets. Many firms were able to judge their performance by internal standards. Wage hikes totally out of line with productivity increases could be passed through in higher prices. Faulty products could be passed on to consumers who had little basis to judge what was possible other than by what was available from domestic sources.

The coming of the global economy changed all that. Capital, resources, people, and goods became far more mobile, and they began to move. The expansion of trade outstripped the expansion of domestic economies, which were rising relatively more rapidly in Europe and the Pacific Rim countries than in the United States. Capital began moving around the world even more rapidly than trade. Competition began springing from almost all points on the globe, and it intensified.

American businesses were taught important lessons in the process of learning to compete. The first lesson taught by the coming of the global economy is that the market power which was once almost guaranteed to domestic business and worker groups has been dissipated.

The second lesson is that Americans can compete when pressed to do so. Not all firms have been able to meet the competition, as evident by the closure of many steel, textile, and shoe factories. Even in these industries, however, some have met world standards of performance, price, and quality. Consider, for example, the great success of Nucor Steel, Milliken Textiles, and Timberlake Shoes.

The third lesson is that firm or domestic standards of performance are no longer relevant; world standards are now the test. Wage costs not justified by productivity increases can no longer be easily passed through in higher prices. Product quality can no longer be measured against a U.S. yardstick.

The fourth lesson is that firms must be global customers as well as producers. They must seek out the lowest cost suppliers from around the world, or else they will have to concede a part of their

domestic and international markets to competitors who do make the search.

And the fifth lesson is that size no longer guarantees continued success. Indeed, large size may be a burden in a world in which flexibility carries a premium.

Competing Visions

Many observers have recognized that current technological trends have created a global market. However, some critics—especially in the United States—have assessed the consequences and policy implications of these trends in a discouraging light. They have charged that these developments need to be opposed by new, innovative government policies—"industrial policies"—designed to "pick winners" and "ease the pain of losers."

Global economic trends, however, have undermined the very capacity of government to do what these policy reformers recommend. The relevant challenge is to shift resources away from political control and into the productive sectors of the economy through tax reform, deregulation, and reduced tariffs.

The remarkable acceleration of capital mobility and the consequent rise of competitive business and government is uncomfortable for individuals in the private and public sectors. Ultimately, however, quicksilver capital promises freedom and opportunity to individuals everywhere. The global economy presents new challenges, but therein lies future growth.

Richard McKenzie and Dwight Lee, both adjunct fellows at the Center for the Study of American Business, are authors of *Quicksilver Capital: How the Rapid Movement of Wealth Has Changed the World* (Free Press, 1991), from which this article is drawn. Dr. McKenzie is Walter B. Gerken Professor of Enterprise and Society at the University of California, Irvine; Dr. Lee is Bernard Ramsey Professor of Economics at the University of Georgia, Athens.

Poland: The First 1,000 Days and Beyond

by Janusz A. Ordover



Poland has just completed the first 1,000 days of its path-breaking Economic Transformation Program from a planned to a market economy. Now is a useful time to ask, how successful has the reform program been, and what are the prospects for the Polish economy?

With the economy on the brink of catastrophe when the Solidarity Government took power at the end of 1989, it devised a "shock treatment" to stop hyperinflation and remove the severe microeconomic distortions that plagued the economy. Fiscal and monetary policies were tightened, controls were imposed on wages and bank credit, the zloty was linked to the dollar, almost all prices were liberalized, subsidies to state-owned enterprises were removed, and preferential treatment of the public sector was ended.

The economy responded quickly to the stabilization measures: month-on-month price inflation fell quickly from about 80 percent to less than 10 percent. Price liberalization extinguished the endless queues of Polish daily life. Exports and imports grew rapidly.

Unfortunately, GDP itself declined by about 12 percent over the course of 1990, and the sales of the industrial state-owned enterprises plummeted by 30 percent. Real wages, which were already falling in 1989, registered an additional drop early in 1990 to about 70 percent of the December 1989 level, though they soon started to rise again.

Despite the fact that the shock therapy seemed initially to be working reasonably well, the state-owned enterprises failed to adjust quickly to the new market environment. They were slow to shed workers and otherwise cut costs, and many firms barely stayed off bankruptcy. Instead, they cut output, which became a major problem for the Polish economy. In addition, budgetary problems and labor unrest took center stage. And among the people there was a growing disenchantment with market reforms.

The state-owned enterprises failed to adjust quickly. They were slow to shed workers. Many firms barely stayed off bankruptcy.

All these problems were exacerbated in 1991. Output continued to fall—GDP fell by another 7 percent and unemployment climbed to 11.8 percent. Nevertheless, inflation persisted at a rate of 60 percent per year. Thus, the government faced a difficult (if familiar) dilemma—how to stimulate the faltering economy without exacerbating inflation and the fiscal deficit, which was estimated to exceed 5 percent of GDP by 1992.

New government leaders took office in early 1992 and worked out a provisional agreement to renew Poland's access to IMF's funds, on the condition that the deficit did not exceed 5 percent of GDP. To re-establish control over the budget, highly unpopular measures were instituted to reduce social welfare expenditures further and to restrain growth in public pensions.

Privatization of state-owned enterprises—another key element of the transformation to a market economy—

progressed much more slowly than initially intended. The first round of "mass privatization" was scaled back to include fewer and fewer state-owned enterprises—down from an initial goal of a thousand businesses or more (out of 8,000-plus) to only 200 enterprises today.

Looking Ahead

So, where is Poland now and what are the forecasts for the near future? Politically, the situation has stabilized, at least for the time being. The economic situation is also showing some welcome bright spots. The best news is that Poland has now enjoyed almost six months of sustained growth in output, suggesting that the worst of the recession may be over. Price inflation, at only 22.4 percent for the first six months of 1992, has been kept in (relative) check. Exports are also performing well.

The private sector is again growing. The number of private firms increased from about 12,000 in 1989 to 51,000 by 1992. Including unincorporated firms, there are now 1.5 million enterprises controlled by individuals. The private sector now accounts for 27 percent of total industrial output, 80 percent of retail trade and agriculture, over 60 percent of road transport, construction and import trade, and 25 percent of exports. Eighty percent of trucks are in private hands. These are impressive numbers.

Unfortunately, only about 1,100 of the large state-owned enterprises have so far been privatized. Plans for a "mass privatization" are now being completed and should get under way in the fall of 1992. This will entail some 600 major state-owned enterprises that will be allocated in several stages among 15-20 yet-to-be-created National Investment Funds, which will be owned by all eligible Poles. The Polish plan differs from those adopted in Czechoslovakia and Russia in that it eschews direct distribu-

(continued on page 7)

Industry Outlook Report

Overview: Decisively Ambivalent



Edgar R. Fowler
The Conference Board

The outlook presented by our industry specialists this month is even more neutral than the three reports published earlier this year. The business cycle expectations of our panel simply offer no excitement at all, either up or down. All of them still call for economic growth, but at an even slower pace than the earlier groups had forecast. Indeed, as our small business specialist reports, we have an economy that is expanding, "but not fast enough to keep up with our ca-

capacity to grow, much less to re-employ idle labor and capital."

The range of expectations among our panelists is surprisingly narrow. Industries that are slightly more upbeat than average are housing, where, although subdued, "the market for 1993 shapes up to be the best in more than four years," and freight transportation, which "should gradually gain momentum." At the more cautious end of the scale is the aerospace industry, where outlays for military aircraft continue to decline and the airlines are both canceling orders for new planes and stretching out future delivery schedules. In between are electronics, minerals, and small business, which are looking for extremely slow gains in the year ahead. Electronics, with a projected global advance of 5-6 percent for 1993, is achieving growth that most industries would envy intensely, but in this industry, 5-6 percent is regarded as anemic.

Health care is the major exception to the mundane pattern, and it is as much of an enigma as ever. Despite its size, it is growing rapidly. Normally this would be a reason for optimism, but not in health care. Costs are rising too rapidly, too many Americans are uninsured, and all proposed policy responses to these problems promise to create more difficulties than they fix. Everything about the industry is an open road to frustration.

Elsewhere, prices and costs are under tight control, and none of our specialists is projecting any major change in that condition. This encouraging evidence about the inflation outlook is the one unadulterated dose of optimism in the report.

The theme of the report is best summarized by our small business specialist, who reports that executives are "firmly positioned just about halfway between expansion and recession. They are, in other words, decisively ambivalent."

Small Business: All Dressed Up but Nowhere to Go



William E. Dunderberg
National Federation of Independent Business

Based on the regular monthly survey of our members, the optimism of small business executives gained a point in August. Twenty eight percent of the firms expect the economy to improve, and only 14 percent expect it to worsen by year end. Thus the group is firmly positioned just about halfway between expansion and recession levels. They are, in other words, decisively ambivalent.

The unpleasant message here is that the economy is expanding, but not fast

enough to keep up with our capacity to grow, much less to re-employ idle labor and capital. Sales trends are also improving and the number of firms reporting profit gains continues to rise as well.

There are two bright spots in the outlook. First, the inflation outlook is excellent, with only 16 percent of the respondents—a record low—planning to raise prices over the next 6 months.

Inventory Position*

as reported by National Federation of Independent Business
(Percentage of Firms)



* Percentages of respondents reporting abundant or lean stock levels are based on a survey of 1,000 firms conducted by the NFIB in August of each year.

Second, inventories are at their leanest levels in the history of the NFIB surveys—since 1973. Indeed, inventories have not been a problem at any time in this recession. In the mid-1980s, after

only 4 years of expansion, more firms thought the economy would slow than expected it to grow, and they began managing their stocks for a downturn. Years later, when the business cycle finally did turn down, most firms were well positioned to weather the storm.

In August, 8 percent of all firms reported inventories "too high," but 12 percent reported inventories "too low." As the chart shows, this represents a record LEAN position—it was only matched once previously, prior to the major inventory correction of 1974. At that time, firms were hoarding inventories, in contrast to the present situation when stocks of inventories are numerically low and very low relative to sales. The only thing lower is the stock of customers!

Prospects for growth are excellent; unfortunately, it's very sluggish growth. Furthermore, it's likely to be with us for awhile as the economy continues to head and position itself for more controlled and solid growth in the future.

Electronics: Uninspiring Growth



Richard O'Brien
Hewlett-Packard

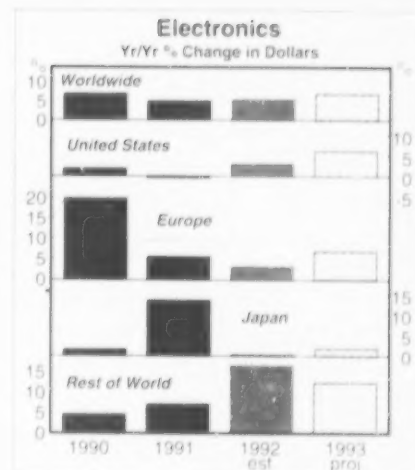
The 1992 world electronics market will be worth \$850 billion. This 5.6 percent growth in the electronics equipment market represents the third year of anemic performance. The U.S. outlook has brightened, but not much. Demand for computer and communications equipment is better than expected. Military electronics, however, continues on the downside.

Overall, the U.S. electronics market is growing at 3 percent. The European market is weak, with the German market being the major culprit. The weakness of

the dollar against the European currencies, particularly the German mark, has masked the weakness of these markets in local currencies. In dollar terms, however, the European market will grow at about 3 percent. The Japanese market for electronic equipment is in a slump, undercut by the soft economy. The yen-denominated value of equipment will fall. However, due to the weakness of the dollar, the Japanese market will be flat in dollar terms.

As the industry heads into 1993, electronic equipment will generally parallel capital equipment spending. Decreases in the prices of computers and related equipment will continue to have significant negative impact on revenue growth, while defense spending continues to be weak. Components, benefiting from the increasing semiconductor content of electronics products, lead the upturn.

The U.S. electronics industry is likely to experience stronger but not robust growth of 6 percent as the U.S. economy



recovers. The European market is slated to stage a slow, 7 percent recovery, but one must wait until 1994 before health returns. It is now abundantly clear that the Japanese market will not be vibrant next year; the market is expected to grow a mere 2 percent. Markets in the rest of the world, particularly Asia, remain the bright spots with double-digit growth rates.

Minerals: Storm Clouds Postpone Recovery



John D.S. Macleod
C R A Limited
(Australia)

New storm clouds have blown up over the world economic outlook. Turmoil in the European currency and interest rate markets combined with slow growth in Japan and a feeble U.S. recovery mean that world economic growth in the second half of 1992 and first half of 1993 will be weak. At best we are now talking about stronger growth in the second half of 1993.

The meager level of world economic growth appears to be insufficient to raise metal demand and hence metal prices significantly above their present depressed levels. A world growth of 2 1/2 - 3 percent is needed to boost demand and this seems at least 12 months away.

There are a number of other forces to be considered. First, the build-up of inventories during the recession: Aluminum inventories, for example, currently stand at about 16 weeks consumption, not an unusual level for this stage of the cycle but nevertheless large enough to constrain early price increases. Second, East Europe/CIS, where a desperate need for foreign currency has resulted in sales of metals into Western markets, thereby depressing prices.

Is there any good news in this generally bleak picture? The answer is "yes", but it's hardly front-page news. In Asia metal demand continues to grow very strongly. The bigger markets are in North

Asia but South Asia is now beginning to grow too. In China and, to a lesser extent, India, major potential exists and the consumption of steel, aluminum, copper, etc., has surged over the past year.

The slow growth worldwide means that metal producers are facing a profit squeeze. Most are reducing costs to ensure they are internationally competitive. Exploration and R&D efforts look promising. The importance of exploration cannot be over-emphasized, since all ore-bodies have a finite life and many were developed back in the 1960s. In addition a number of processing plants are quite old and, with poor profit experiences over a long period (e.g. steel), investors are cautious about building new facilities.

Finally, the industry remains plagued by developmental delays. Access to land, environmental constraints and other difficulties could imply supply shortages later in the decade.

Health Care: No Magic Bullet



Jack Michael
New Directions for
Policy Editor

The U.S. health care system is rapidly approaching \$1 trillion of total expenditures. Ironically, even as total spending soars, about one of seven Americans has no health insurance, and millions more are underinsured.

Another paradox in health care is the combination of underspending on preventive medicine and basic primary care and mounting evidence of unnecessary care in the form of excessive diagnostic tests and inappropriate surgery.

We forecast total health expenditures of \$832 billion in 1992. Next year, total

spending should be in the range of \$926 billion, and it is almost certain to reach or top \$1 trillion in 1994 (see table).

Sharply rising health care costs are adding to the pressure on government budgets and employers' labor costs. Medicare is likely to run out of money in the early part of the next century. Medicaid costs have nearly doubled in the last three years. And business contributions for health care are increasing at double-digit rates annually.

There is no quick fix or magic bullet to end these problems. The forces driving up health care costs, including technological development, economic growth, behavior and lifestyle, and the organization of our health care system, are not easily altered. Furthermore, to be successful in denting the long-term growth of expenditures on health care, a new policy will have to place con-

straints on either the free choice of providers, access to advanced medical technology, or both.

We face two basic policy choices. First, we must decide whether to finance an extension of coverage to the uninsured primarily through government subsidies or through a more regressive, "off-budget" tax on business. Second, to contain costs we must decide whether to use incentives or controls. Using incentives is more likely to encourage innovation and promote high-quality care. Government controls, however, are more likely to bring short-term relief, albeit at the expense of some queuing and stifling of innovation.

Projected Growth of Health Care Expenditures

	(billions of dollars)		
	1992	1993	1994
Total Health Care Expenditures*	832	926	1030
Medicare Outlays	131	149	166
Medicaid Outlays	124	145	169
Employer Health Insurance Premiums	197	220	252

* Estimates by New Directions for Policy, Washington, DC.
Source: Health Care Financing Administration projections.

Freight Transportation: Gradually Gaining Momentum



Kenneth F. Anderson
American Trucking
Association

Following 1991 losses that ranged from painful to catastrophic, all freight modes have shown some improvement in 1992. In particular, trucking showed an 8 percent increase in operating revenues and a rise in profit margin from a measly 1.3 percent in the first half of 1991 to a slightly healthier (though

still inadequate) 2.2 percent in the first half of 1992.

All modes of freight transportation, however, continue to experience overcapacity, which, along with a generally low



rate of inflation, is acting to hold down prices. Industrial production, a com-

monly used gauge of demand for freight services, has risen by less than 2 percent during the first three quarters of 1992. Even with an increase in the number of firms exiting the industry, there is not enough freight to go around. Survivors have been squeezing costs hard, by eliminating jobs (notably among railroads) and installing productivity-enhancing communications systems, routing and other software, and electronic data interchange with customers. All modes have been spared a repeat of the devastating fuel-price increases of 1990.

All of these trends are expected to continue over the next 18 months. Industrial production, and hence freight volumes, should gradually gain momentum. Fuel, labor and other costs will rise slowly if at all, allowing for moderate improvement in profits.

Housing: Continued Modest Improvement



David W. Hyman
Editor, AIAA

The housing market has taken its usual role of recovering more quickly than most other parts of the economy. Housing starts are expected to rise almost 20 percent this year, while new home sales should be up by slightly more and existing home sales should increase by about 9 percent. All three markets were well on their way to these gains in late September.

Despite these seemingly strong increases, however, this housing recovery has been more subdued than usual—mirroring the national recovery. The lowest

mortgage rates, and highest levels of affordability, in nearly 20 years have had a positive impact on the housing market, but slow economic growth and weak consumer confidence—stemming from a stagnant labor market—have held down the housing recovery.

The most recent forward-looking indicators of the housing market, the monthly survey of builders from the National Association of Home Builders and the weekly survey of mortgage applications from the Mortgage Bankers Association, both indicate that the housing market is poised for renewed growth. The strength of this additional recovery will, however, depend on mortgage rates remaining relatively low and—even more important—on improving labor markets. If employment growth remains sluggish, then poor consumer confidence will prevent low levels of mortgage rates from

fully translating into stronger home sales and construction.

With only a modest pickup in the economy next year, we expect housing starts to rise by almost 9 percent. The legacy of tax-induced overbuilding in the 1980s will continue to haunt the multifamily sector, however, keeping multifamily housing starts at depressed levels. New home sales should respond to still-low mortgage rates and moderately better labor markets with a gain of about 11 percent, with existing home sales up by more than 7 percent. As a result of these increases, the housing market for 1993 shapes up to be the best in more than four years, although the recovery will remain more subdued than usual.

The Housing Market

	(millions of units)		
	1991	1992	1993
Housing Starts	1.01	1.21	1.31
New Home Sales	0.81	0.61	0.67
Existing Home Sales	1.25	1.81	1.77

Aerospace: The Watchword is Caution



Dr. Richard H. Johns
McDonnell Douglas
Corporation

Near term, the watchword for the aerospace industry is caution. Growth in the industry has temporarily (we hope!) stalled as the commercial transport segment responds to an adverse global economic environment. New aircraft orders have slowed as carriers have canceled orders and stretched out delivery schedules. The civil transport aircraft backlog at the end of 1991 stood at 2,781 planes worldwide, a decline of 12 percent from a year earlier. This segment should rebound as the economic climate improves, especially since many carriers

need to replace older aircraft in their fleets.

The industry's defense segment continues to decline, a trend that will continue as long as no new threat to international stability emerges. New development programs are giving way to upgrades and extensions of existing weapon systems. A defense spending "floor" will eventually be reached, but budgets seem headed for levels akin to post-World-War-II and post-Vietnam lows. Aerospace industry employment is projected to decline from a 1989 peak of 1,331,000 to 1,086,000 by the end of 1992.

The space segment is projected to continue to grow, but at a decreasing rate. Funding for Space Station Freedom remains vulnerable to the threat of cancellation from Congress. General aviation deliveries have been in decline since 1989, but business aircraft sales are projected to grow once an economic recovery gets under way.

In the future, smaller, leaner, and fewer aerospace firms will look for commercial market recovery, teaming opportunities,

globally oriented strategies, and new technology applications. Margins will begin to improve as companies become more streamlined and the defense portion of the industry puts behind it the now discredited firm-fixed-price-development contracts of the late 1980s. Defense and space projects will compete in our political process with national infrastructure improvement and social benefit programs. International sales will face the same pressures, as other nations make similar defense cuts. Worldwide economic recovery will have the biggest positive effect on industry sales and profits.



tion of "vouchers" that can be used to purchase shares in privatized enterprises. In Poland, the concern is that a direct voucher scheme would lead to such diffused ownership of enterprises that managers will be left without effective control.

To re-establish control over the budget, highly unpopular measures were instituted to reduce social welfare expenditures further and to restrain growth in public pensions.

Many serious economic problems still persist. Although recently improved, concerns remain about the unsettled labor situation; these concerns are delaying badly needed foreign invest-

ments in some of Poland's more antiquated industries. Lack of clearly defined property rights, inadequate bankruptcy law, poorly developed labor and housing markets, bureaucratic red tape, and concerns about liabilities for environmental damages from existing state-owned enterprises have further deterred foreign capital. Importantly, however, many major corporations are pressing on: Levi Strauss, International Paper, Coca Cola, ABB, Fiat, and CPC have all made major investments in Poland. Moreover, it now appears that Poland will be able to renegotiate access to the IMF's short-term loan facility.

If the government can maintain a tight wage policy and keep the lid on the budgetary deficit over the next six months, Poland's prospects may be better than at any time in the last 18 months. This will require that social spending, now 21 percent of GNP compared with 11 percent in 1989, be re-

duced, and that revenues, now about 25 percent of GNP, be increased. Such macro-economic discipline will not be easy since the finances of state-owned enterprises are increasingly desperate, many social expenditures have already been slashed, and alternative sources of tax revenues (such as the VAT) are not yet in place. This summer's catastrophic drought has added to the already precarious economic situation.

In sum, the economic situation remains precarious and the odds are probably less than even that Poland will dig itself out of recession any time soon.

Janusz A. Ordover is Deputy Assistant Attorney General for Economics, Antitrust Division, U.S. Department of Justice, and Professor of Economics, New York University (on leave). He was formerly an advisor to the Polish Ministry of Finance and the Anti-Monopoly Office. The views expressed here are solely those of the author.

The World Bank's Recommendations for Privatizing State Enterprises

The more market-friendly a country's policy framework, the less difficult it will have in privatizing a state enterprise, and the higher the likelihood that the sale will turn out positively.

State enterprises functioning in competitive markets, or in markets easily made competitive, are prime candidates for privatization. Their sale is simple, compared to public monopolies, and they require little or no regulation.

Before privatizing monopolies, appropriate regulations must be in place. Failure to regulate properly can hurt consumers and reduce public support for privatization.

The primary objective of privatization should be to increase efficiency—not to maximize revenue (for example, by selling into protected markets), nor even to distribute ownership widely at the expense of efficiency.

Countries can benefit from privatizing management through management contracts, leases, contracting out or concessions.

Rather than restrict the market by excluding foreign investors and favoring certain ethnic groups, experiment with "golden shares" and partial share offerings to win acceptance for foreign and other buyers.

Experience shows that labor does not, and need not, lose in privatization, if governments pay attention to easing the social cost of unemployment through adequate severance pay, unemployment benefits, retraining and job search assistance.

Avoid large new investments in privatization candidates; the risks usually outweigh the rewards. Instead prepare for sale with financial workouts, with labor shedding, and with legal, managerial and organizational changes.

Ideally, let the market set the price and sell for cash. Realistically, negotiated settlements and financing arrangements or debt/equity swaps may be unavoidable.

In all privatizations, in all countries, the transaction must be transparent.

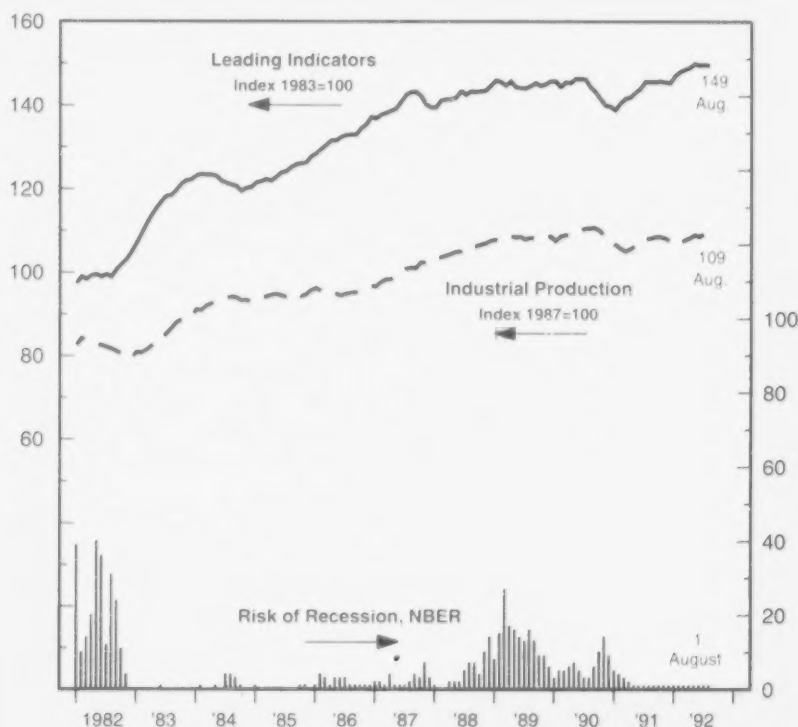
Source: "Privatization: The Lessons of Experience," The World Bank, 1992.

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But End It Will

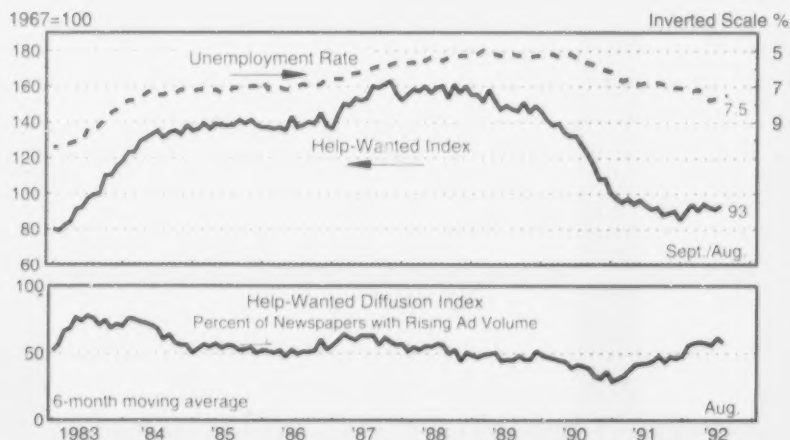
It's difficult to recall when the business cycle was quite so torpid as it is now. The table borrowed from Maureen Allyn (Exhibit of the Month, p. 10) illustrates this nicely: For every sector adding energy to the system, there is another acting as a brake. It's an extremely frustrating economy, not generating enough expansion to re-employ the idle workers and plants, but also not displaying enough weakness to compell more dramatic policy action. What will trigger an acceleration of the cyclical recovery, sooner or later? Perhaps a new departure of fiscal or monetary policy, perhaps natural forces such as revived consumer sentiment, the need to rebuild depleted inventories, improved profitability spurring new investment, and the like. At present there's nothing in sight to suggest this wallowing in the doldrums will end soon. But end it will. (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

Early Warning Indicators



Business cycle upswing struggles forward.

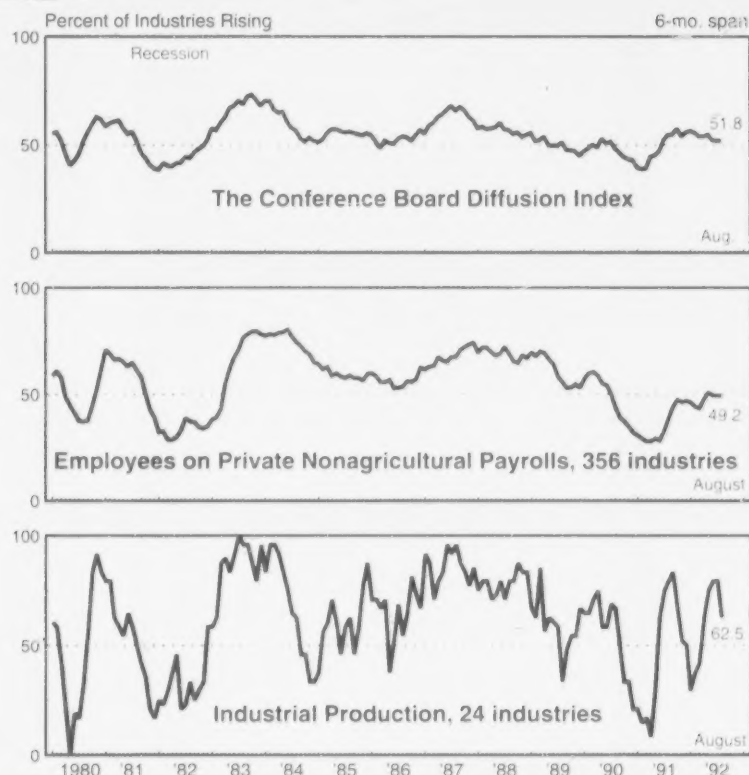
Help-Wanted Advertising and Unemployment



Labor demand improving marginally, but still very weak.

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Indexes of Economic Momentum



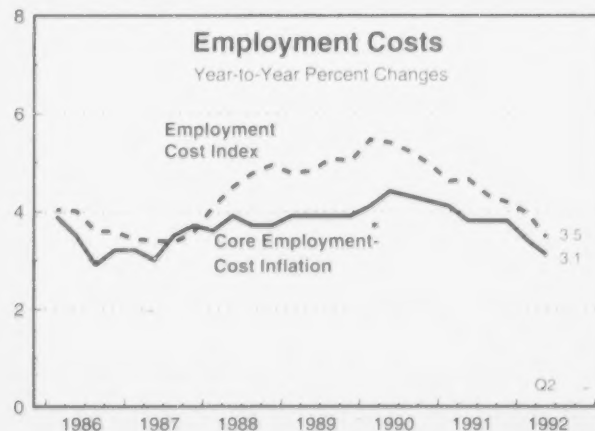
*No momentum,
either up or down.*

*Core inflation
continues to improve.*

Inflation Fundamentals



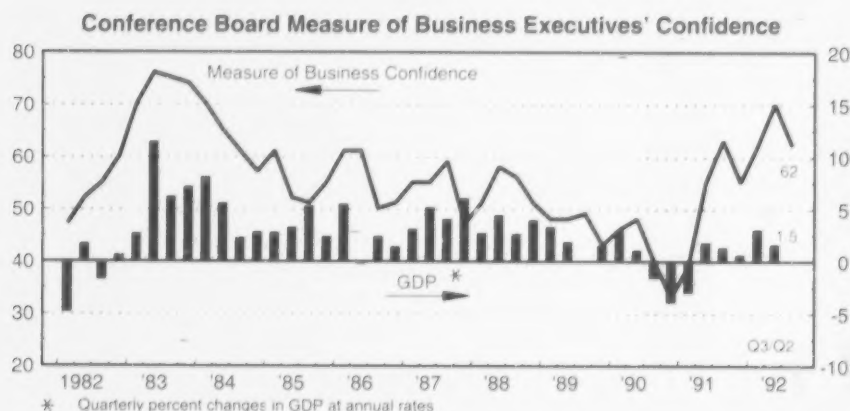
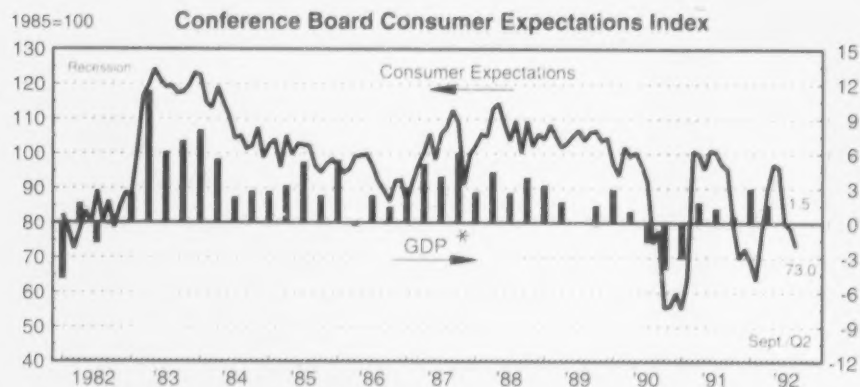
* Core Inflation = CPI excluding food at home and energy



* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

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Confidence



Consumer confidence drops still another notch.

Exhibit of the Month

The U.S. Economy: Macho Man or Wimp?

Strengths

- Inflation slow
- Balance sheets improving
- Short-term interest rates low
- Capital spending rising
- Profits rebounding
- Productivity rising
- Single family starts climbing
- Inventories lean
- Exports highly competitive

Weaknesses

- Debt loads high
- Borrowing cautious
- Real long-term interest rates high
- Consumer spending languishing
- Wage gains modest
- Unemployment high, job growth slow
- Offices and apartments overbuilt
- Federal deficit still bloated
- Defense outlays falling fast

Conclusion: Yes it is, Isn't it?

Source: Maureen Allyn, Chief Economist, Scudder Stevens and Clark

Inside the Crystal Ball

UCLA
MERRILL L.
DU PONT
GEORGIA ST.
NORTHERN TRUST
CONF. BOARD
EATON
L.H. MEYER
DRI
WEFA
MICHIGAN - RSQE

Date of Forecast Sept. Sept. Sept. Sept. Sept. Sept. Sept. Sept. Sept. Sept. Aug.

Gross Domestic Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%	%	%	%		
Actual	1992 1Q	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	1Q 1992	Actual
	2Q	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.4	2Q	
Forecast	3Q	0.7	1.5	1.3	1.1	2.0	1.3	1.8	1.6	1.7	1.6	1.3	3Q	Forecast
	4Q	1.8	1.6	1.9	2.5	2.9	1.6	3.1	2.1	2.9	2.7	3.1	4Q	
	1993 1Q	2.0	1.8	3.2	3.2	3.1	1.7	4.1	2.7	2.9	3.0	3.9	1Q 1993	
	2Q	2.8	2.6	3.8	2.8	3.1	2.7	4.1	2.9	3.5	3.2	3.6	2Q	
	3Q	3.5	2.8	3.8	2.8	3.0	2.4	3.6	3.3	3.1	2.9	3.1	3Q	
	4Q	3.5	3.0	3.7	2.2	2.8	2.1	2.6	3.1	3.3	2.7	2.6	4Q	
	1994 1Q	3.6		3.6	2.1		1.7	3.0	3.1	3.1	2.9	2.7	1Q 1994	
	2Q	2.6		3.6			1.9	1.4	3.1	2.9	2.8	2.6	2Q	
	3Q	2.2		3.7			1.9	2.0	2.8	2.1	2.8	2.4	3Q	

Inflation (Deflator)

(Percent change from same quarter one year earlier)

Actual	1991 4Q	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	1991 4Q	Actual
Forecast	1992 4Q	3.6	3.4	3.7	3.6	3.8	3.8	3.4	3.6	3.2	3.5	3.2	1992 4Q	Forecast
	1993 4Q	2.7	3.0	3.1	3.2	3.0	3.5	3.0	2.3	2.8	2.7	2.4	1993 4Q	

30-Yr Treasury Bond Rate

(Percent, quarterly)

Actual	1992 1Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	1Q 1992	Actual
	2Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	2Q	
Forecast	3Q	7.4	7.4	7.5	7.4	7.5	7.4	7.4	7.4	7.5	7.5	7.5	3Q	Forecast
	4Q	7.2	7.3	7.3	7.4	7.4	7.5	7.1	7.2	7.4	7.4	7.4	4Q	
	1993 1Q	7.3	7.4	7.4	7.4	7.3	7.7	7.2	6.9	7.3	7.5	7.4	1Q 1993	
	2Q	7.3	7.7	7.6	7.6	7.3	7.8	7.2	6.7	7.3	7.5	7.4	2Q	
	3Q	7.4	7.8	7.8	7.7	7.3	7.9	7.2	6.6	7.3	7.6	7.4	3Q	
	4Q	7.5	7.9	7.9	7.9	7.4	8.0	7.2	6.5	7.4	7.7	7.3	4Q	
	1994 1Q	7.5		8.0	8.1	7.4	8.0	7.2	6.3	7.5	7.8	7.2	1Q 1994	
	2Q	7.5		8.0		7.5	8.1	7.0	6.2	7.6	7.9	7.2	2Q	
	3Q	7.6		8.0			8.1	7.0	6.1	7.5	8.0	7.2	3Q	

Unemployment Rate

(Percent, quarterly)

Actual	1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	4Q 1991	Actual
Forecast	1992 4Q	7.7	7.7	7.6	7.5	7.5	7.8	7.6	7.7	7.6	7.6	7.6	4Q 1992	Forecast
	1993 4Q	7.0	7.0	6.9	7.1	7.0	7.7	7.0	7.1	6.9	7.0	7.0	4Q 1993	
	1994 3Q	6.6		6.3			7.6	6.4	6.5	6.4	6.6	6.8	1Q 1994	



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